Part 1 The Legal Environment of Business CHAPTER 6 Criminal Law and Business Page 112 CASE OPENER A Questionable Stock Investment For approximately 20 months, Robert E. McDonald perpetrated a scheme to solicit millions of dollars, purportedly for a $100 million purchase by the RAI Entities and certain other related corporate entities, of approximately 14 Marriott and Hilton branded hotels. He made false representations that the RAI Entities and/or related entities had already raised substantial capital assets toward the purchase of the Midwest Hotel Portfolio, that the RAI Entities and/or Related Entities had tens of millions of dollars on deposit at various financial institutions, including J.P. Morgan and Citibank, and that investor funds would be put toward the purchase of the Midwest Hotel Portfolio. The defendant knew that these representations were false. The defendant created phony bank statements that he provided to the hotel investor and failed to inform the hotel investor that he had been previously convicted for fraud offenses and was currently under federal supervised release. After having obtained approximately $1,486,323 from a hotel investor and sending the investor stock certificates by Federal Express from New York, New York, the defendant caused the hotel investor's funds to be diverted to the defendant's own use, including through an interstate wire transfer of approximately $145,000 on or about January 15, 2010, to a Citibank account the defendant maintained in New York, New York. Which crimes do you believe that McDonald committed? Does it matter that the stock certificates were sent via Federal Express rather than the U.S. Mail? LEARNING OBJECTIVES LO 6-1 Explain the basic elements of a crime. LO 6-2 Explain how are crimes classified. LO 6-3 Recognize who can be held responsible when a corporate crime is committed. LO 6-4 Outline the basic steps of a criminal proceeding. LO 6-5 Describe the laws that attempt to prevent white-collar crime. Page 113 Crime comes in many forms, and sometimes the number of people affected can quickly grow. Although some crimes might at first seem victimless, there is always a victim, and especially with white-collar crimes, there are often many victims. Imagine, for example, if McDonald had not just offered his "investment opportunity" to one person, but to several. In many crimes involving securities, the perpetrator lures not just one victim into his fraudulent scheme, but many. This chapter helps the future business manager recognize when conduct has become criminal. The discussion begins by introducing the elements of a crime and explaining some common crimes that occur in the business context. After discussing how liability can be imposed on corporations and corporate executives, the chapter sets forth the steps of criminal procedure. The chapter concludes by discussing some of the laws used to fight business crime.

The Nature and Elements of a Crime LO 6-1 Explain the basic elements of a crime. The purpose of criminal law is to punish an offender for causing harm to public health, safety, or morals. In a criminal proceeding, the government files the charges against the defendant. Thus, the government is always a party to a criminal action. Government involvement distinguishes criminal trials from civil proceedings. As you may recall from Chapter 3, an individual person or corporation can file a civil lawsuit. This difference exists because in a criminal trial, society is seen as the victim, whereas a civil trial involves an individual victim or victims. In many situations, a particular course of conduct may lead a defendant to be prosecuted for committing a crime and to be sued in civil court for compensation by the victims of the crime. The outcome of the two cases may not be the same, however, for a number of reasons. As you will learn, the precise elements needed to prove the resulting criminal and civil cases will be different, and whereas many of the steps of civil and criminal procedure are the same, the defendant has additional protections in the criminal case. For example, the burden of proof in the criminal case is beyond a reasonable doubt, which is a much higher standard than that of a civil case, which, as you learned in Chapter 3, is a preponderance of the evidence. You will learn about many of the additional protections afforded criminal defendants later in this chapter. Elements of a Crime Criminal laws usually define criminal behavior and set guidelines for punishment. To punish an individual for criminal behavior, the government must demonstrate the two elements of a crime: Wrongful behavior, that is, actus reus (guilty act). Wrongful state of mind, also known as mens rea (guilty mind). The government thus must show that a defendant committed a prohibited act with a wrongful intent. To prove the first element, actus reus (guilty act), the government must establish the nonmental elements of the crime. That is, the government must demonstrate that a prohibited act or a prohibited consequence resulted because of the behavior of the defendant. To prove the second element, mens rea (guilty state of mind), the government must prove that the defendant acted with the state of mind required by the law defining the relevant offense. The state of mind required by an offense may be purposeful, knowing, reckless, or negligent. The defendant’s type of wrongful state of mind helps determine the seriousness of the punishment for the crime. A defendant can purposefully commit a crime by engaging in a specific wrongful behavior to bring about a specific wrongful result. For example, a person who robs a bank at gunpoint to unlawfully gain money is acting purposely. A defendant can knowingly

commit a wrongful act if the person knows the act is wrongful or believes that the act is wrongful yet does nothing to confirm or disconfirm this belief. The distinction between purposely and knowingly committing a crime can be subtle, but still distinct. For example, say a person wants to murder an enemy by blowing up the office building in which his enemy works. The perpetrator is aware that this act will likely kill other people in the building but does not care. The perpetrator would be purposely murdering his enemy but knowingly murdering the other people in the building. Page 114 A defendant is reckless if a criminal act occurs when the individual consciously ignores substantial risk. Drinking and driving is a common example of a reckless crime. Driving while under the influence of alcohol carries significant and apparent risks for the driver and others; choosing to do despite those risks is acting recklessly. Finally, a defendant is negligent if he or she does not meet a standard of care that the reasonable person would use in the context that led to the criminal act. For example, a parent leaving his children in a hot car while the parent is having a good time at a bar would acting criminally negligent. In certain cases, liability may be assessed even without establishing the guilty-mind criterion just mentioned. Only certain crimes, typically violations of regulatory statutes, allow punishment to be assessed without having to prove a guilty mind. When liability is assessed without the guilty-mind criterion, it is known as liability without fault or strict liability. Liability without fault involves actions that, regardless of the care taken, are deemed illegal to engage in; such acts are specifically prohibited regardless of state of mind. Liability without fault would apply, for example, if a business were to sell cigarettes or alcohol to a minor. Although the business might not have intended to sell cigarettes or alcohol to a minor (thus lacking a guilty mind), the statutory violation still allows liability to be imposed. Classification of Crimes LO 6-2 Explain how crimes are classified. Crimes are divided into categories based on the seriousness of the offense. Today, the categories used are felonies, misdemeanors, and petty crimes. Felonies include serious crimes, such as murder, that are punishable by imprisonment for more than one year in a penitentiary or by death. Misdemeanors are less serious crimes punishable by fines and/or imprisonment for less than one year. Petty offenses, such as violating a building code, are minor misdemeanors and are usually punishable by a jail sentence of less than six months or a small fine. The statute defining the crime usually establishes whether the crime is a felony, misdemeanor, or petty offense. Crimes may also be federal or state, depending on whether they are created by the state or federal legislature.

White-Collar Crime Originally, white-collar crimes were distinguished from other crimes because of the social status of the offender. The more modern approach is to define white-collar crime as a variety of nonviolent illegal acts against society that occur most frequently in the business context. Clearly, the crimes described in the Case Opener fall under this broad definition of white-collar crime. Mail fraud, bribery, embezzlement, and computer crimes are examples of offenses typically classified as white-collar crimes. These crimes occur more frequently than you might think. According to some estimates, one in three American households is the victim of white-collar crime every year. The consequences of white-collar crimes are far-reaching. First, the cost of white-collar crimes can be tremendous. According to some estimates, fraud in the health care industry alone costs society over $100 billion each year. Second, when company employees commit the crime, many companies fail to report the crime to avoid publicity. Third, white-collar crimes can be costly to the environment. For example, improper disposal of chemicals, such as dumping chemicals in a stream, has long-term repercussions for marine life, the surrounding ecosystem, and any humans who may come in contact with the contaminated water source. Of course, the amount of money collected in fines from corporate executives engaged in criminal activity has not been insignificant either. For example, in 2010, the federal government collected $2.8 billion in restitution, criminal fines, and felony assessments in criminal cases.1 Fines, however, are only one way that those found guilty of fraud and other white-collar crimes might be punished. Page 115 There are at least four other ways to punish white-collar criminals. First, incarceration has been mandated for certain types of white-collar crimes. As the prevalence of white-collar crime has increased, so too has the number of white-collar offenders who are in jail. Second, white-collar criminals may be ordered to do community service, such as giving speeches about business crime. For instance, junk-bond king Michael Milliken was compelled to give speeches about corporate crime after he was convicted of insider trading. Third, judges may disqualify the individual from employment. For instance, the judge may prohibit the offender from engaging in an occupation in which the same or a similar criminal act could occur again. Fourth, the offender can be placed under house arrest. Individuals must wear a sensor so that the government can monitor whether they have left their houses. With changes in technology, and governments that are increasingly pressed financially, governments are increasingly looking for sentences other than imprisonment for nonviolent offenders. People in the criminal justice

field are also starting to recognize that there is something wrong with a system that results in a higher incarceration rate in the United States than in other industrialized nations. According to the most recent statistics, the United States was incarcerating 770 persons per 100,000, whereas the rate in Europe was around 110 per 100,000. Specific White-Collar Crimes Bribery One of the better-known white-collar crimes is bribery. Bribery is the offering, giving, soliciting, or receiving of money or any object of value for the purpose of influencing the judgment or conduct of a person in a position of trust. Bribery of a public official is a statutory offense under federal law. The purpose of this law against bribery is to maintain the integrity of the government. This statute also covers bribes offered to witnesses in exchange for testimony. Perhaps one of the most publicized examples of bribery was the 2002 Winter Olympics bribery scandal in Salt Lake City, Utah. The Salt Lake City Olympics Bid Committee allegedly gave International Olympic Committee members between $4 million and $7 million in cash and other benefits. These benefits included college tuition assistance payments, shopping trips for bathroom fixtures and doorknobs, and trips to the Super Bowl. More common, however, is the simple cash bribe to obtain a government contract. For example, in 2008, the CEO of a multimedia communications company was convicted of paying over $200,000 in bribes to the technology director of Atlanta Public Schools to secure contracts to help connect schools in poor and rural areas to the Internet. He was sentenced to a five-year prison term and payment of restitution. The government official who had accepted the bribe, and ultimately testified against the man who bribed him, was sentenced to three years in prison.2 To demonstrate bribery under this statute, the government must show three elements: (1) something of value was offered, given, or promised to; (2) a federal public official with; (3) intent to influence that person’s judgment or conduct. The “thing of value” element has been construed very liberally; actual commercial value is not necessary. For instance, had the Salt Lake City Olympics Bid Committee given a member of the International Olympic Committee shares of stock in a new Silicon Valley start-up called BellyUp.com but the shares turned out to be worthless because the start-up was never established, this act may constitute bribery even though the stock is commercially worthless. Ultimately, the Department of Justice was unable to prove any of the 15 charges of bribery that it had filed against two members of the Salt Lake City Olympics Bid Committee. Several members of the committee resigned, however. As a result of investigations into the matter, 10 members of the International Olympics Committee were fired and another 10 were sanctioned. Additionally, the definition of “public official” is also

expansive. The statute defines public officials as members of Congress, government officers and employees, and anyone “acting for or on behalf of” the federal government “in any official function, under or by authority of” a federal government department or agency. For example, individuals who work for private corporations that have some degree of responsibility for carrying out federal programs or policies are considered public officials. Page 116 Another type of bribery is commercial bribery, which includes a bribe in exchange for new information or payoffs. For example, suppose Comdac Computers is looking for a company that manufactures a certain type of computer part. Jane Devlon owns such a company and realizes that if Comdac gets the computer parts from her, she will potentially make a lot of money. When Comdac sends its contractor to the Devlon factory, Devlon offers the contractor $500,000 in exchange for the contractor’s promise that Comdac will buy all such parts from only her factory for the next year. Alternatively, she might offer the contractor $5,000 to disclose the dollar amounts of the competing bids so that she can offer a better bid to earn the contract. One final type of bribery is the bribery of foreign officials. The purpose of the Foreign Corrupt Practices Act (FCPA) is to combat such bribery. The FCPA prohibits payments to foreign officials to influence an official act or decision corruptly or to influence a foreign government. You might think of the FCPA as an extension of the law to prevent bribery of a public official. The FCPA allows the government to prosecute those who bribe foreign officials. But Congress does not pass laws affecting foreign affairs in a vacuum. Laws governing white-collar crime, like all laws, are dynamic, and one source of change in these laws is international law. Multinational organizations in which the United States is a member often pressure the United States to alter American law so that it conforms to certain international standards. Thus, for example, Congress amended the FCPA in 1998 to conform to the antibribery convention adopted by the Organization for Economic Cooperation and Development (OECD). The amendments broaden the scope of actions the FCPA covers and the definition of a public official. As of this writing, 30 OECD countries—such as Japan, South Korea, and Brazil—are expected to adopt similar antibribery statutes. Extortion Often confused with bribery, but completely different, is the crime of extortion. Extortion, otherwise known as blackmail, is the making of threats for the purpose of obtaining money or property. Whereas bribery is offering someone something to obtain a desired result, extortion involves the threat of doing something if the target of the extortion does not relinquish money or a specific piece of property. Fraud Criminal fraud encompasses a variety of means by which an individual intentionally uses some sort of

misrepresentation to gain an advantage over another person. Fraud generally requires the following three elements: (1) a material false representation made with intent to deceive (scienter), (2) a victim's reasonable reliance on the false representation, and (3) damages. Both the federal and the state governments have passed a number of statutes codifying specific types of fraudulent schemes. These schemes to defraud include a multitude of frauds, such as credit card fraud, insurance fraud, and securities fraud. Exhibit 6-1 summarizes the fraudulent acts that might occur in the corporate setting, many of which are discussed in this chapter. Exhibit 6-1Selected Fraudulent Crimes Forgery: The fraudulent making or altering of any writing in a way that changes the legal rights and liabilities of another. Defalcation: The misappropriation of trust funds or money held in a fiduciary capacity. False entries: The making of an entry into the books of a bank or corporation that is designed to represent the existence of funds that do not exist. False token: A false document or sign of existence used to perpetrate a fraud, such as making counterfeit money. False pretense: A designed misrepresentation of existing facts or conditions by which a person obtains another's money or goods, such as the writing of a worthless check. Fraudulent concealment: The suppression of a material fact that a person is legally bound to disclose. Mail fraud: The use of mails to defraud the public. Health care fraud: Any fraudulent act committed in the provision of health care products or services. Telemarketing fraud: Any scheme, including cramming and slamming, using the telephone to commit a fraudulent act. Ponzi scheme: An investment swindle in which high profits are promised from fictitious sources and early investors are paid off with funds raised from later ones. Check kiting: Drawing checks on an account in one bank and depositing them in an account in a second bank when neither account has sufficient funds to cover the amounts drawn. Just before the checks are returned for payment to the first bank, the kiter covers them by depositing checks drawn on the account in the second bank. Due to the delay created by the collection of funds by one bank from the other, known as the float time, an artificial balance is created. Pretexting: Using fraudulent means to obtain information about someone's phone use. One of the FBI's largest securities fraud crackdowns occurred in June 2000, when it arrested a group of mafia leaders for a series of scams that cost investors an estimated $25 million. Government officials claimed that the mob bought large stakes in small companies and then bribed and coerced brokers to promote the stocks to other investors at inflated prices. The Enron scandal also involved securities fraud, with Enron's top executives allegedly overstating its earnings to maintain high stock prices. Complex accounting methods were

used to hide the corporation’s debt. Enron’s top executives and big investors sold their stocks while encouraging employees to continue buying company stocks. With the drastic decline in the company’s stock value, many Enron employees lost much of their 401(k) investments. Another specific type of securities fraud in the Enron case is insider trading. Insider trading is generally the buying or selling of a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, nonpublic information about the security. Enron’s big investors and top executives knew the stock prices were inflated due to overstated earnings. They used this information, which was not public knowledge, to sell off their stock before the price fell. Page 117 In March 2011, another apparent insider-trading scheme came to light when it was alleged that a corporate lawyer and a trader operated an insider-trading scheme that lasted decades and earned the two $32 million. The lawyer worked for a mergers and acquisitions firm, and he gave nonpublic information about deals the firm was working on to his partner, the trader, so that he could make appropriate stock trades using this information. One of their alleged profitable inside trades occurred when information that the lawyer acquired in April 2009 about Oracle’s proposed bid for Sun Microsystems led the trader to purchase more than 4 million shares of the target company, which he was then able to make a handsome profit on when the deal closed in 2010.3 Insider-trading violations may also include “tipping” such information and trading on it by the person “tipped.”4 A tippee who receives such information with the knowledge that its disclosure breached the tipper’s duty acquires that duty and may be liable for securities fraud for any undisclosed trading on the information. Thus, if a person has inside information and does not trade on it himself but passes it on to another who uses it to trade, the person who passed on the information is guilty of insider trading. Tippee liability requires that the tipper’s disclosure breaches a fiduciary duty, which occurs when the tipper discloses the information for a personal benefit. A personal benefit may be inferred where the tipper receives something of value in exchange for the tip or makes a gift of confidential information to a trading relative or friend. The following case illustrates how the U.S. Supreme Court recently clarified how to establish a tippee’s liability. Page 118 Stock-option backdating is yet another type of securities fraud that the SEC has been increasingly cracking down on. Backdating occurs when an employee falsifies documents to make it appear as though the company had granted options on certain dates, but the dates are selected after the fact by looking backward for dates on which the stock price was low, thereby falsely inflating the net profits of the company. In 2007, Myron F. Olesnyckyj, the former general

counsel of Monster Worldwide, Inc., pleaded guilty to securities fraud for participating in a multiyear scheme with other Monster executives to secretly backdate stock options granted to thousands of Monster officers, directors, and employees, including himself. By backdating and improperly accounting for options, Monster granted undisclosed compensation to its employees, failed to recognize compensation expenses, and overstated its net income by $340 million from 1997 through 2005. Olesnyckyj personally made $381,000 from the scheme, which he agreed to forfeit. Page 119 An additional type of fraud is false pretense. False pretense is the illegal obtaining of property belonging to another through materially false representation of an existing fact, with knowledge of the falsity of the representation and with the intent to defraud. For example, Jim goes door-to-door selling vacuum cleaners at an amazing discount. To obtain the discount, the customers must pay immediately, and the vacuum cleaner will be delivered in three to five business days. However, Jim possesses no vacuum cleaners and does not plan to deliver any. Jim has committed the crime of false pretense because he illegally obtained another's property (the money he received as payment) by making a false representation (telling the customers they would be receiving a vacuum) with the knowledge of the falsity (he knew there were no vacuum cleaners) and the intent to defraud (he did not plan to deliver any vacuum cleaners). Forgery, the fraudulent making or altering of any writing in a way that changes the legal rights and liabilities of another, is another type of fraud. If you sign your colleague's name to the back of a check made out to your colleague, you have committed forgery. One of the most frequently prosecuted frauds is mail fraud, which is the use of mails to defraud the public. The Mail Fraud Act of 1990 makes mail fraud a federal crime. To prove mail fraud, the government must demonstrate two elements: (1) an intent to defraud and (2) the use of or causing the use of mails to further the fraudulent scheme. Case 6-1 demonstrates how the courts address the second element. CASE 6-1 SALMAN v. UNITED STATES United States Supreme Court 137 S. Ct. 420 (2016) FACTS: Petitioner Salman was indicted for federal securities-fraud crimes for trading on inside information he received from a friend and relative-by-marriage, Michael Kara, who, in turn, had received the information from his brother, Maher Kara, a former investment banker at Citigroup. Maher testified at Salman's trial that he had shared inside information with his brother Michael to benefit him and expected him to trade on it. Michael testified to sharing that information with Salman, who knew that it was from Maher. Salman was convicted. ISSUE: If an insider just gives inside information to an outsider without receiving a financial payment for that information, can the insider still be held liable for

insider trading? REASONING: The Securities Exchange Act of 1934 as well as SEC Rule 10b-5 prohibit undisclosed trading on inside corporate information. It is also prohibited for someone with insider information to give, or tip, that information to others for trading. The receiver of insider information, or tippee, acquires the tipper's duty to disclose the inside information or abstain from trading on it. In Dirks v. SEC, the Supreme Court ruled that the tippee's responsibility derives from the fact that the tipper breached a fiduciary duty when disclosing the information for personal benefit. This personal benefit can even include when the tipper is giving the confidential information as a gift to a relative or friend. In this case, Salman argued that giving a gift of information to a relative does not constitute securities fraud. Salman contended that a tipper does not personally benefit unless he or she gains something of tangible value in exchange for the information. However, the Supreme Court ruled that Dirks is quite clear that when a tipper gives inside information to a trading relative or friend, a jury can infer that it is equivalent to a cash gift (the assumption being that the trades made on the information will make money in the future). In these cases, the tipper benefits personally in the same way that giving someone a tangible money gift benefits personally. When Maher tipped the information to Salman, Maher breached a duty of trust to Citigroup and its clients—a duty which Salman inherited and breached himself by trading on the information. DECISION AND REMEDY: Yes, he can. And therefore Salman's conviction for insider trading was affirmed. SIGNIFICANCE OF THE CASE: This case illustrates that tipping and/or trading based on insider information—regardless of the type of information, who tipped it, and the reasons for tipping—is invariably illegal; there really is not any way around insider trading restrictions. CRITICAL THINKING How would you evaluate the court's claim that giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds? ETHICAL DECISION MAKING Which stakeholders benefit the most from the decision in this case? CASE 6-2 UNITED STATES v. VEGA-MARTÍNEZ United States Court of Appeals for the First Circuit 949 F.3d 43 (2020) FACTS: In 2013, Vega-Martínez, Garay-Rodríguez, and their codefendants owned competing bus companies that sought to provide busing for low-income students from Caguas to public schools in the area. That year, the municipality announced that it would hold an auction for four-year school-bus-transportation contracts. Instead of independently submitting competing bids, the conspirators met and agreed to divide up the routes among themselves. For each route, a "winner" was predesignated, and that "winner" was assured that, at most, only one other bidder would bid on the route (to make it look like there was competition),

and that bid would be a high bid. After the meeting, bids were submitted. The municipality rejected all of the high bids and instead negotiated contracts with each of the low bidders without realizing what had happened. The municipality then sent award letters to the successful defendants in the mail. Over a year later, news of the bid rigging leaked. One of the bus-company owners had taped the meeting at which the scheme was put together. In May 2015, the defendants were charged in an indictment alleging conspiracy to restrain trade, conspiracy to commit mail fraud, and substantive mail fraud. All defendants were convicted on all charges, and were each sentenced to a prison term of one year and one day, plus a year of supervised release. Following trial, conviction, and sentencing on charges of mail fraud and violations of the Sherman Act, Luciano Vega-Martínez and René Garay-Rodríguez appealed, raising a variety of issues, including a claim that there was not enough evidence to convict the defendant of mail fraud. ISSUE: What kind of evidence would be sufficient to convict the defendants of mail fraud? REASONING: Here the government presented evidence to establish both elements of a mail fraud conviction: that the defendant (1) devised or intend[ed] to devise a scheme to defraud and (2) use of the mail for the purpose of executing or attempting to execute a fraudulent scheme. The government presented clear evidence of a scheme to defraud through the testimony of Aldea-Rodríguez and documentary evidence of the bids, including the defendants' certifications that their bids were “fair and free of collusion or fraud,” a statement that the jury obviously decided was false. The government then showed that the scheme required a relevant and foreseeable use of the mail because the defendants received the object of the conspiracy—their contract award letters—by certified mail. Proof of mail fraud does not require proof of an actual mailing by the specific defendant, only that the defendants caused the use of the mail, which includes reasonably foreseeable mailings and mail used for the purpose, or in furtherance, of executing the scheme to defraud. Aldea-Rodríguez's testimony and tape recording of the meeting at which the conspiracy was hatched, as well as documentation of the defendants' phone calls and bid submissions, sufficiently supported a finding that the defendants agreed to submit fraudulent bids and cause the municipality to send out award letters based on that fraudulent information, which proves a conspiracy to commit mail fraud. SIGNIFICANCE OF THIS CASE: This case provides an example of how the government establishes mail fraud and also shows that the defendants do not actually have to use the mail themselves as long as they cause the use of the mail in furtherance of their fraudulent scheme. In other words, the victim of the scheme may actually be the one who uses the mail.

CRITICAL THINKING Can you think of any alternative interpretation of the mail fraud statute that, had it been adopted, could have prevented the defendants conviction from being upheld? ETHICAL DECISION MAKING Had he considered the public disclosure test before joining in the conspiracy, how might the defendant have acted in this case? Explain what his reasoning would have been in taking an alternative course of action. Page 120 Congress amended the mail fraud statute in 1994 to include commercial carriers and courier services as substitutes for the U.S. mail. Thus, using FedEx or UPS to further a fraudulent scheme can be prosecuted as mail fraud. Similarly, the wire fraud statute attempts to prevent the use of wire, radio, or television transmissions to defraud the public. Other types of fraud include health care fraud, telemarketing fraud, and bankruptcy fraud. The Department of Justice recently named health care fraud its top priority after violent crime. An example of health care fraud is the submission of false claims to insurance plans such as Medicare or Medicaid. Additionally, some doctors prescribe unneeded equipment to patients and then receive kickbacks from the manufacturers of the equipment. Telemarketing fraud has also gained much attention. The National Fraud Information Center reported that telephone cramming was the top telemarketing fraud of 1998. Cramming is a scheme in which companies bill consumers for optional services that the consumers did not order. Another frequent telemarketing scheme is slamming, in which consumers are tricked into changing their phone service to another carrier without their consent. In 2014, the FTC settled a long running case against a group of defendants who engaged in text message, robocall, and cramming schemes involving offers for “free” merchandise, recovering approximately $10 million. The elderly, who have been more susceptible to telemarketing fraud, are often the specific targets of telemarketing schemes. Thus, the Department of Justice and the FBI have been collaborating on various undercover operations, such as Operation Senior Sentinel, to investigate and prosecute fraudulent telemarketers. Another type of fraud involves bankruptcies. In 2014, 1,107,699 bankruptcy claims were filed. An individual can file for bankruptcy to be relieved of oppressive debt. Yet claims need to be reviewed carefully to prevent bankruptcy fraud. For example, an individual might hide some assets so that these will not be considered during the proceedings. Or, as one of the stars of the Real Housewives of New Jersey show did, a person might hide part of her income. In the Real Housewives case, the housewife claimed to be unemployed, even though she had allegedly just signed a contract for a second season of Real Housewives, and she did not reveal her income from website sales and personal and magazine appearances. Conversely, a

creditor (a party to whom another owes money) might file a false claim against a debtor (the party who owes money to a creditor). Thus, bankruptcy fraud can occur on the part of the debtor or the creditor, although 70 percent of bankruptcy fraud claims involve concealment of assets by the debtor. The U.S. Department of Justice estimates that 10 percent of all bankruptcy petitions contain some elements of fraud. Yet, according to a report by the U.S. Department of Justice, in fiscal year 2012, the United States Trustee Program (USTP) filed 2,120 criminal referrals, a 7.7 percent increase over the 1,968 criminal referrals made during fiscal year 2011. One way the Justice Department is attempting to fight bankruptcy fraud is through its Internet hotline, where the public can report suspected bankruptcy fraud to the USTP. Page 121 Bankruptcy fraud is punishable by a fine of up to $250,000 and/or up to five years in prison, but often the person who engages in bankruptcy fraud is also engaging in another crime, such as tax evasion, which can result in greater penalties. For example, in 2013, Larry Lake was sentenced to 168 months in prison and ordered to pay $550,000 in fines and approximately $25 million in taxes, interest, and penalties for bankruptcy fraud and tax evasion. The day before he filed for bankruptcy, he had knowingly and fraudulently transferred and concealed more than $3 million held in an online trading account and a bank account. He had transferred the funds through a series of bank deposits, wire transfers, and cashier’s checks and used a shell company to help hide assets. Sometimes fraud cases can be very complex and involve multiple types of fraud. For example, in one recent case, a Beverly Hills lawyer was convicted of three counts of mail fraud, seven counts of wire fraud, and five counts of lying in a court hearing. In an elaborate fraudulent scheme, the lawyer had purchased a yacht for $1.9 million, sold it to two partners to drive up its insurance value, and then had a company he owned repurchase the yacht and insure it for $3.5 million. Finally, he and his partners sank the yacht and tried to collect the insurance. BUT WHAT IF. . . Former Mets outfielder Lenny Dykstra went to court for fraud in 2012. While Dykstra owned a mansion formerly owned by Wayne Gretzky, he claimed that he was over $31 million in debt and his total assets amounted to only $50,000. Thus, he was seeking to file for bankruptcy. If Dykstra secretly hid and sold $400,000 worth of possessions yet on the stand said he had only a few items put into his storage unit, would he be accountable for only bankruptcy fraud or other types of fraud as well? Alternatively, if Dykstra had reviewed the sold, stored, and destroyed items with a bankruptcy trustee, would he be liable for fraud at all? A fraudulent crime that has recently come into the public eye is pretexting. Pretexting can be defined as using or causing others to use false pretenses, fraudulent

statements, fraudulent or stolen documents, or other misrepresentations, including posing as an account holder or employee of a telecommunications carrier, to obtain the telephone records of another. Pretexting entered the national lexicon in 2006 when news broke that the investigators hired by Hewlett-Packard's board of directors to locate the source of several leaks to the media were engaging in this practice. Under the federal Telephone Records and Privacy Protection Act of 2006, anyone convicted of employing fraudulent tactics to persuade phone companies to hand over confidential data about a customer's calling habits can be sent to prison for up to 10 years. Some states also have statutes outlawing pretexting. Both individuals and businesses can be victims of fraud. To minimize the chances that your firm will be a victim of fraud, review the fraud prevention tips in Exhibit 6-2 very carefully. Exhibit 6-2Fraud Prevention Tips Red Flags Suggesting Possible Fraud When you are looking at a brochure offering an investment opportunity that seems almost too good to be true, it may indeed not be as good as it seems, especially if it contains these red flags of fraud: No independent proof of profitability: The brochure provides the investment strategy but includes no details that can be verified, such as names and addresses of specific companies in which it invests. Control by a single person. No audited financial statements and no evidence of internal controls. Unusually high rates of return: The rates of return are significantly higher than those for other funds with a similar investment strategy. New investors' reliance primarily on existing investors in deciding to invest. False Assurances That an Investment Opportunity Is Not Fraudulent Long-time existence of investment opportunity: A Ponzi scheme can operate for a long time. As long as the company keeps getting new investors, it can continue to use the new investors to pay off the few who insist on collecting their returns. Many investors may be content to accumulate paper profits, especially if there is a financial incentive for reinvestment of profits. For example, the Financial Advisory Fund had been in business for almost 20 years before its fraudulent foundation was uncovered. A list of names and addresses of satisfied investors you can contact: All such schemes will have some satisfied investors who have received payments from the new investment money. Membership in the Better Business Bureau: Any company can pay to join. If most of the investors have not attempted to withdraw their funds and the company is still getting new investments, there will be no disgruntled investors to complain to the BBB. A report of profitability from Dun & Bradstreet: Dun & Bradstreet does not do an independent financial audit of a company's profits. As stated on its website, Dun & Bradstreet simply provides the information regarding profits that it receives from companies.

Acceptance of money rolled over from IRAs: There is no government check on the soundness of firms that roll over IRAs. Bank references: If a firm simply has a large amount of money in a checking account in a bank and has never sought a loan from the bank, the bank would have no reason to do any due diligence on the firm. Also, if the owner of the firm is personable and the account has never been overdrawn, the bank personnel may well give the firm a good reference. Glossy brochures and television ads: All you need for both is some money and the knowledge that many people may be overly impressed by a fancy brochure or ad campaign. These tips come from Barry Minkow, who went from starting his own carpet cleaning business at the age of 16, to taking this multimillion-dollar company public at the age of 20, to facing a 23-year prison sentence and $26 million victim restitution payment at the age of 21 for massive fraud and theft perpetuated on behalf of his company, to now being a pastor and the cofounder of the Fraud Discovery Institute. The fascinating story of how Minkow, through fraudulent Ponzi schemes, check kiting, and theft, managed to build the multimillion-dollar ZZZZ Best Carpet Cleaning Company by the age of 20 is contained in his book, Cleaning Up. The book also provides insights into why some people may commit white-collar crimes, describes many of the long-running frauds Minkow helped to uncover since deciding to use his understanding of the perpetuation of fraud to help uncover and prevent it, and how he became a preacher. Unfortunately, Minkow’s conversion was not permanent, and in 2014 he was sentenced to five years in prison for embezzling $3 million from his San Diego church congregation. Ponzi schemes are another form of fraud that Americans are increasingly seeing discussed in the news. A Ponzi scheme is a fraudulent operation in which the operator, an individual or organization, pays returns to its investors from new capital paid to the operators by new investors rather than from profit earned by the operator. In early 2009, Bernie Madoff, the perpetrator of one of the largest Ponzi schemes to date, was charged with 11 felony charges, including securities fraud, investment adviser fraud, mail fraud, wire fraud, three counts of money laundering, false statements, perjury, false filings with the United States Securities and Exchange Commission, and theft from an employee benefit plan. Global Context Digital Archive Japan/Alamy Stock Photo Embezzlement and Bribery in China On March 8, 1982, in response to a concern about a rise in white-collar crimes, Chinese officials added a resolution entitled “Severely Punishing Criminals Who Do Great Damage to the Economy” to the Chinese Criminal Code. The provision targeted top-ranking officials by providing that any state functionaries who extort, accept bribes, or exploit their office will no longer receive the fixed-term punishment

(usually 10 years) allocated for bribery and extortion. Instead, those officials found guilty of extortion and accepting bribes would be sentenced to life imprisonment or possibly put to death. Bank fraud is another white-collar crime that may be punishable by death. In 2004, China executed four people, including employees of two of its Big Four state banks, for fraud totaling $15 million. Three of the cases involved China Construction Bank. A former accounting officer at this bank worked with others to steal 20 million yuan ($2.4 million) from the bank by using fake papers. He and an accomplice were executed, along with another Construction Bank employee who was found to have taken 20 million yuan from the bank in an unrelated case. Additionally, an official employed by the Bank of China was executed for cheating. The precise number of people executed in China is not made available to the public. Estimates range from 5,000 to 10,000 a year, for crimes including murder, corruption, and, on occasion, even bottom-pinching. Most are executed by a single shot in the back of the head. Such punishments may seem extreme, but the reaction of the Chinese to the increase in white-collar crime reflects the culture's unusually great concern for social harmony. Madoff ultimately pled guilty to all 11 counts and was subsequently sentenced to a term of imprisonment of 150 years for this crime, which was estimated to have cost investors losses of $18 billion. As of April 2014, the government had seized $2.35 billion in corporate and personal assets from Madoff that were to be distributed to victims of the fraud. Even though Madoff was prosecuted in 2009, it wasn't until 2014 that five of his former aides were convicted on grounds that they had helped him conceal his massive fraud for years. In a trial that lasted five months, back-office director Daniel Bonventre, portfolio managers Annette Bongiorno and Joann Crupi, and computer programmers Jerome O'Hara and George Perez pled guilty on all counts, including securities fraud and conspiracy to defraud clients. Prior to this trial, nine other people pled guilty in connection with Madoff's fraud. Page 122Page 123 A $300 million Ponzi scheme involving real estate investments led to Fred "Dave" Clark Jr., the founder and CEO of Cay Clubs, being convicted on three counts of bank fraud and making a false statement to a financial institution and one count of obstructing the SEC by lying to the agency. In 2016, he was sentenced to 40 years in prison and fined $303.8 million for the bank fraud and $3.3 million for obstruction charge. He also was ordered to forfeit $2.6 million in overseas assets, and to to pay the U.S. Internal Revenue Service over $1.5 million in restitution for taxes owed on unreported income. The way this crime unfolded was that Cay Clubs sold condos as condo-hotel vacation units in the Keys, Clearwater, and Las Vegas and promised renovations and big payouts to the investors, but,

instead, used new buyers' money to pay lease-back fees owed to earlier buyers while extracting $22 million from the company. Clark used the money to buy waterfront homes, cars, and planes. The scheme lasted almost four years before collapsing on itself. Embezzlement Joe is Kathleen's attorney. Kathleen gave Joe $5,000 to put in escrow, an account to which Joe will have access, although the money is not his to use as he pleases. Suppose Joe takes some of that money out of the account and uses it to gamble, and he fixes the records to cover up the fact that he has used some of the money for his personal use. He has committed the crime of embezzlement, the wrongful conversion of another's property by one who is lawfully in possession of that property. Embezzlement is distinguished from larceny because the individual did not take the property from another; he was already in possession of the property. Embezzlement usually occurs when an employee steals money. Thus, it is often employees in banks who commit the crime. However, as the recent embezzlement of $6.9 million from the American Cancer Society demonstrates, even nonprofit organizations are vulnerable to the crime of embezzlement. Even the Girls Scouts have been victims of embezzlement. A Girl Scout Troop leader pocketed the proceeds of her troop's annual Girl Scout Cookie Sale, as well as a portion of a donation made to the troop by a family member of a deceased troop leader. The embezzlement came to light only when the troop was unable to afford to participate in their ordinary scouting activities.5 White-collar crimes such as embezzlement are a problem in many countries. For example, the Chinese government, which has been focusing on economic crimes, caught employees in two major Chinese banks altering deposit slips and bank orders to direct the money to personal accounts throughout China. Those employees received death sentences for embezzlement, as discussed in the Global Context box. Page 124 Computer Crimes The term computer crime refers broadly to any wrongful act that (1) is directed against computers, (2) uses computers to commit a crime, or (3) involves computers. Computer crime is not necessarily a new kind of crime but is, instead, a new way of committing traditional crimes. Fraud, for example, is a crime that has existed for centuries. Today, online auctions, such as eBay, are a common source of fraud in the United States. But electronic fraud is not the only costly computer related crime. According to the FBI, dealing with viruses, spyware, PC theft, and other computer crimes cost U.S. businesses $67.2 billion. Computer crimes are often difficult to prosecute, in large part because they are difficult to detect. A computer crime could be committed by an insider, such as an employee, or by an outsider, such as a hacker—a person who illegally accesses or enters another person's or a company's computer

system to obtain information or to steal money. In addition, computer systems are quite open to attack. The American Society for Industrial Security has reported that the losses from computer crimes in a single year were more than $250 billion for U.S. companies. Furthermore, the attacks are frequent. The IRS alone detects 800 to 1,200 cases of computer system misuse annually. A cyber terrorist is a hacker whose intention is the exploitation of a target computer or network to create a serious impact, such as the crippling of a communications network or the sabotage of a business or organization. The activity of a cyber terrorist can have an impact on millions of citizens if the terrorist's attack is successful, particularly if it involves the computer systems of a major stock exchange, any bank, or any federal agency or government. In an attempt to aid prosecutions of computer crimes, Congress passed the Counterfeit Access Device and Computer Fraud and Abuse Act of 1984 (also know as the Computer Fraud and Abuse Act, or CFAA). The act prohibits six broad categories of computer crimes: Unauthorized use of or access to a computer to obtain classified military or foreign policy information with the intent to harm the United States or to benefit a foreign country. Unauthorized use of a computer to collect financial or credit information protected under federal privacy law. Unauthorized access to a federal computer and the use, modification, destruction, or disclosure of data it contains or the prevention of an authorized person's use of such data. Alteration or modification of data in financial computers, causing a loss of $1,000 or more. Modification of data that impedes medical treatment to individuals. Fraudulent transfer of computer passwords or similar data that could aid unauthorized access that either (a) affects interstate commerce or (b) permits access to a government computer. Computer crimes falling into the first category are felonies, whereas the others are misdemeanors. The National Information Infrastructure Protection Act of 1996 amended the Computer Fraud and Abuse Act. One of the major changes to the CFAA is the substitution of the term protected computers for federal interest computers so that the statute now protects any computer attached to the Internet. In a further attempt to aid prosecution of computer crimes, the U.S. Department of Justice formed the Computer Crime and Intellectual Property Section (CCIPS) in its Criminal Division. Attorneys in this division prosecute only federal computer crimes. They also coordinate their activities with numerous government entities, the private sector, scholars, and foreign representatives in an attempt to develop a global response to computer crime. Destruction of data is one of the most serious problems facing companies today. A virus is a computer program that rearranges, damages, destroys, or replaces computer data. Thus, if an employee or a

hacker creates and releases a virus, a company can easily lose vital information. Until recently, the most economically destructive computer crime to date was the creation of the Love Bug virus. In May 2000, the virus spread rapidly throughout the world by email. Once the email was opened, it destroyed files on the user's computer, and then the virus sent itself to every address in that computer's email address book. In the end, the virus caused more than $10 billion in damages and halted computers in major companies and government agencies worldwide. However, over the weekend of May 12, 2017, unknown cyberhackers launched "Wanna Cry," believed to be, as of when this book went to press, the biggest online extortion attack ever recorded. The global "ransomware" attack struck governments, universities, and private firms in over 150 countries, causing a wide range of problems. For example, in London, a fifth of the National Health Services that manage the hospitals were hit, leading to thousands of canceled appointments and operations. E-Commerce and the Law E-Commerce and the Law Crime has moved online alongside the digitization of society. Ever since personal information became accessible online, criminals have moved to exploit it. Instead of lifting financial statements from mailboxes, thieves could now pilfer private data from their personal computers. Computer crime has only grown in frequency and scope. In 2017, credit reporting agency Equifax announced it had been hacked and the personal information of over 147.9 million U.S. citizens had been compromised. If you've ever had a credit card or a loan before 2017, chances are, hackers have your name, birth date, and social security number. Computer crime is not solely about stealing personal information. As recently as 2018, researchers found sensitive corporate documents, such as blueprints, from automakers such as Tesla, Toyota, and Volkswagen sitting on the internet. But stealing information isn't the only trick hackers play today. According to the federal Cybersecurity and Infrastructure Security Agency (CISA), the latest growing cybersecurity threat is ransomware. Ransomware is a type of malicious software that encrypts data on breached computers. The only one who can undo the encryption is the hacker. In other words, the hacked firm can no longer access their data. California University was a ransomware victim in 2020 and paid the hackers $1.14 million to restore their data access. In another 2020 malware incident, Finastra, a fintech company that serves more than 90 of the top 100 banks globally, opted to shut down their servers instead of paying the ransom. Although Finastra restored their digital infrastructure using backups, their clients experienced outages until the restoration was finished. As you can see, poor cybersecurity can be very costly. In May of 2021, DarkSide Ransomware Gang staged a ransomware attack on the Colonial Pipeline that

shut down the oil pipeline the energy company manages until the firm paid a $4.4 million ransom in Bitcoin, of which $2.3 million was recovered by the FBI's Digital Extortion Task Force. Ransomware attacks are such a problem that, on October 8, 2021, the president signed intolaw the bipartisan K-12 Cybersecurity Act of 2021 to provide school districts with IT security resources to combat threats and protect themselves against cyberattacks including ransomware. Page 125 Companies can try to prevent the destruction of data by installing virus detection programs on their computers. However, the detection programs recognize only previously existing harmful files. As a result, if someone creates a new virus, the detection program is useless. When an employee uses his or her computer in a manner not authorized by the employer, the employee has committed a crime. Employers, then, must clearly communicate with employees about authorized versus unauthorized behavior. For example, if an employee uses her work computer to run her own personal business on the side, her employer may argue that she is engaging in theft because she is not using her computer in an authorized manner. Thus, when you become a business manager, you will want to make sure that you explicitly list acceptable computer uses, along with the penalties associated with unauthorized use.

Corporate Criminal Liability LO 6-3 Recognize who can be held responsible when a corporate crime is committed. An individual or a corporation can be charged with and convicted of a crime. However, there has been much debate over whether corporations should be held criminally responsible. Under the common law, a corporation could not be considered a criminal because it was not an actual person and thus did not have a mind. Consequently, it could not meet the mens rea (guilty-mind) requirement for a crime. Slowly, however, courts began to impose liability on corporations for strict-liability offenses, those offenses that do not require state of mind. Next, courts imposed liability on corporations by imputing the state of mind of the employee to the corporation. Currently, corporations can be held criminally accountable for almost any crime. However, they cannot be held liable for crimes that are punishable only by a prison sentence. For a corporation to be held criminally liable for the acts of an employee, the prosecutor must show that (1) the employee was acting within the scope of her or his employment; (2) the employee was acting with the purpose of benefiting the corporation; and (3) the act was imputed to the corporation. In addition to corporations

having criminal liability, corporate executives may also be personally liable for a business crime. The beneficiary of the crime is irrelevant because corporate executives and officers can be found to be personally liable regardless of whether the crimes were committed for their personal benefit or for the benefit of the corporation. Page 126 Also, under the “responsible corporate officer” doctrine, a court may assess criminal liability on a corporate executive or officer even if he or she did not engage in, direct, or know about a specific criminal violation. As Case 6-3 demonstrates, corporate executives sometimes have the responsibility and power to ensure the company’s compliance with the law. If the executive fails to meet this responsibility, the executive can be held criminally liable. CASE 6-3 UNITED STATES v. PARK United States Supreme Court 421 U.S. 658 (1975) FACTS: Defendant Park, the president of a national food-chain corporation, was charged, along with the corporation, with violating the Federal Food, Drug, and Cosmetic Act by allowing food in the warehouse to be exposed to rodent contamination. Park had conceded that his responsibility for the “entire operation” included warehouse sanitation, but he claimed that he had delegated the responsibility for sanitation to dependable subordinates. He admitted at trial that he had received a warning letter from the Food and Drug Administration regarding the unsanitary conditions at one of the company’s warehouses. The trial court found the defendant guilty. The court of appeals reversed. The case was appealed to the U.S. Supreme Court. ISSUE: Can corporate executives be criminally liable for failing to ensure a company’s compliance with the law? REASONING: The Supreme Court has noted that the only way corporations can act is through their individual employees. The act in question, the Federal Food, Drug, and Cosmetic Act, requires stringent, affirmative actions on the part of corporate executives, but these standards are justified by the public interest in food safety. We expect executives such as Park to exercise appropriate authority and demonstrate supervisory responsibility. There is considerable evidence that Park had a duty to ensure sanitary conditions and that he violated that duty by failing to ensure that those to whom he delegated responsibility did their jobs. The Court said: “[T]he requirements of foresight and vigilance imposed on responsible corporate agents are beyond question, demanding, and perhaps onerous, but they are not more stringent than the public has a right to expect of those who voluntarily assume positions of authority in business enterprises whose services and products affect the health and well-being of the public that supports them.” DECISION AND REMEDY: The U.S. Supreme Court reversed the appellate court’s reversal of the trial court’s conviction, finding that corporate executives can be criminally liable for failing to ensure

a company’s compliance with the law. SIGNIFICANCE OF THE CASE: This case signaled to corporate officials that they could no longer use ignorance as a defense, because a court will hold high-level corporate actors responsible for their company’s failure to comply with the law, even if they were unaware of what was going on within their company. CRITICAL THINKING Given the rule laid down in this case, could the defendant have presented any evidence that would have led to a different decision? ETHICAL DECISION MAKING Suppose you were in Park’s position in this case. You allegedly allowed food in your warehouse to be exposed to rodent contamination. If you were guided by the public disclosure test, what would you decide to do? Page 127 Since United States v. Park, the general rule that corporate executives may be held accountable for the crimes arising from their failure to meet their responsibility has remained intact. The rule has, in fact, broadened so that now executives can be held criminally liable for offenses that we generally do not think of as crimes. For example, in United States v. Iverson,6 a corporate officer of a waste treatment facility was convicted and sentenced for violating the Clean Water Act after he ordered employees to dispose of wastewater illegally. This case demonstrates that corporate executives can be sentenced not only for committing the common law crimes that we have traditionally understood to be criminal offenses but also for violating provisions of regulatory statutes that permit criminal sanctions. In such cases, vicarious liability, or liability imposed on one person for the acts of another, is assessed to the corporate executive. In fact, courts have held that employers are vicariously liable for the wrongful acts of their employees if the employer directed, partook in, or authorized the wrongful act. CASE Nugget Can a Corporate Executive Be Held Liable for Murder or Manslaughter? While we do not typically think of murder or manslaughter as being white-collar crimes, if corporate employees’s decisions lead to the deaths of customers, the corporate decision makers may well find themselves charged with murder or manslaughter. A good illustration of this situation is the indictment in 2018 of five corporate employees and a corporation because of the death by decapitation of a 10-year-old child riding a 17-story waterslide. The slide in question required two or three riders to be strapped onto a raft, and according to the park’s website, the raft would “slide down a jaw-dropping 168-foot-7-inch structure, only to be blasted back up a second massive hill and then sent down yet another gut-wrenching 50-foot drop for the ultimate in water slide thrills.” The child was decapitated when the raft few into the air and collided with overhead hoops and netting attached to the slide. The indicted parties included the two designers of the slide, one of whom was a co-owner of the park, the former operations

manager of the park, and the companies that constructed the slide and operated the park. Allegations in the indictment included a claim that one of the defendants who was responsible for many of the design decisions had no technical and engineering expertise and that there were multiple flaws in the design, some of which caused the design to violate long-standing safety standards in the industry. The indictment also alleged that the constructions was rushed, leading to its opening in an unfinished and unsafe condition, and that employees knew of similar accidents with the slide causing injuries to at least 10 other riders, and that defendants lied to investigators.7 In 2019, however, the charges were dismissed due to multiple abuses by the state attorney general in the grand jury process, including the presentation of impermissible evidence to the grand jury. Despite the dismissal, however, the case is worth thinking about because it reminds us that there is always the possibility that manslaughter charges will be filled when management decisions lead to death. Cases charging corporate executives or corporations with murder or manslaughter are certainly uncommon. The first such charges were filed in a case arising out of the death of an employee from cyanide poisoning. The now defunct Film Recovery Systems was charged with involuntary manslaughter, and two corporate officials and two management-level employees were charged with murder. The indictments alleged that the company employed illegal workers who did not speak English, could not read warning labels, were not given the necessary safety equipment, and were forced to work in conditions that were likely to lead to death or serious injury. While the prosecution was unsuccessful, and there have not been many attempts to pursue such charges since that time, perhaps the case against the Schlitterbahn Water Park is the beginning of a new turn in regulating corporate behavior.8 Source: Marilia Brocchetto and Melissa Gray., CNN, Kansas water park executives charged with Murder in boy’s death, https://www.cnn.com/2018/03/27/us/schlitterbahn-waterpark-death-arrests/index.html (March 27, 2018); Schlitterbahn faces criminal case after Kansas boy decapitated on 17-story waterslide, Dallas News, https://www.dallasnews.com/news/us-news/2018/03/23/schlitterbahn-faces-criminal-case-after-kansas-boy-decapitated-17-story-waterslide.

Criminal Procedure LO 6-4 Outline the basic steps of a criminal proceeding. Criminal procedure differs from civil procedure in several key ways. First, the government, referred to as the prosecutor, always brings the criminal case,

whereas in a civil case, the party filing the case, the plaintiff, can be an individual, business, or government entity. Second, the outcome of each is different. In a criminal case, the objective is punishment, so the defendant may be fined or imprisoned; in a civil case, the objective is to remedy a wrong done to the plaintiff, so the defendant either will have to provide compensation to the plaintiff or may be subject to an equitable remedy such as an injunction or order for specific performance. Third, because the potential impact of losing a criminal case is so much more serious than the impact of losing a civil case, the Constitution provides a number of safeguards for the criminal defendant. These safeguards are set forth in Exhibit 6-3. Exhibit 6-3Constitutional Provisions That Safeguard Criminal Defendants' Rights AMENDMENT PROVISIONS Fourth Protection from unreasonable search and seizure. Restrictions on warrants. Fifth Prohibition of double jeopardy. Right not to incriminate oneself. Right to due process. Sixth Right to a speedy and public trial. Right to a trial by an impartial jury of one's peers. Right to be informed of the accusations against oneself. Right to confront witnesses. Right to have witnesses on one's side. Right to counsel at various stages of the proceedings. Eighth Freedom from excessive bail. Freedom from excessive fines. Freedom from cruel and unusual punishment. Fourteenth Extension of the right to due process in all state matters. Extension of most constitutional rights to defendants at the state level. Pretrial Procedure Prior to an arrest, grand juries may conduct criminal investigatory proceedings or issue a grand jury subpoena for company records. Criminal proceedings generally begin when an individual is arrested for a crime. A law enforcement officer must perform the arrest. This officer is often a police officer but may also be an agent of another government agency, such as the Bureau of Alcohol, Tobacco and Firearms; the Federal Bureau of Investigation; or the Immigration and Naturalization Service. A law enforcement officer should obtain an arrest warrant before an individual is taken into custody. Ordinarily, to obtain an arrest warrant, the law enforcement agent must demonstrate that there is probable cause, or a likelihood, that a suspect committed or is planning to commit a crime. A magistrate, the lowest-ranking judicial official, issues the arrest warrant. In certain circumstances, however, courts have recognized that law enforcement agents can arrest a suspect without a warrant if the officer believes there is probable cause but not enough time to obtain the warrant. Page 129 When law enforcement agents arrest individuals, the officers must inform the individuals of their Miranda rights. If they fail to do so, any information a defendant offers at the time of the arrest is not admissible at trial. To comply with the Supreme Court's requirements for protecting a

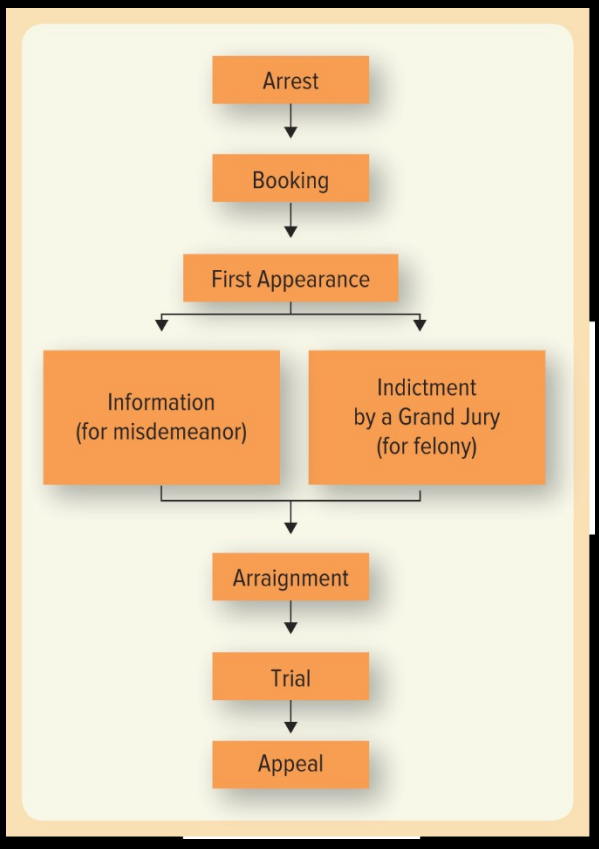
citizen’s rights, a law enforcement officer must inform the defendant of the following facts before questioning: “You have the right to remain silent and refuse to answer any questions.” “Anything you say may be used against you in a court of law.” “You have the right to consult an attorney before speaking to the police and have an attorney present during any questioning now or in the future.” “If you cannot afford an attorney, one will be appointed for you before the questioning begins.” “If you do not have an attorney available, you have the right to remain silent until you have had an opportunity to consult with one.” “Now that I have advised you of your rights, are you willing to answer any questions without an attorney present?” The Miranda rights are not absolute. In fact, the Supreme Court has several times created exceptions to the Miranda rights. For example, in New York v. Quarles,9 the Court created a public-safety exception to the Miranda rights. This exception allows statements to be used at trial, even if a person was not informed of his or her Miranda rights, if the need to protect the public is served by the admissibility of the statements in question. After being arrested and read their Miranda rights, defendants are taken to the police station for booking, a procedure during which the name of the defendant and the alleged crime are recorded in the investigating agency’s or police department’s records. After the prosecutor files the complaint, the defendant makes the first appearance, which is the appearance before a magistrate who determines whether there was probable cause for the arrest. If the magistrate ascertains that probable cause did not exist, the individual is freed. If the defendant committed a minor offense and pleads guilty, the magistrate sentences the individual. However, if the defendant claims innocence, the magistrate ensures that the defendant has a lawyer, or appoints one, if necessary, for an indigent defendant, and sets bail. Bail is the amount of money defendants pay to the court on release from custody as security that they will return for trial. Next, the prosecutor has a choice: Should the case be prosecuted? The Principles of Federal Prosecution, established by the U.S. Department of Justice, suggest that at the federal level the decision to prosecute depends on two primary factors: (1) whether the evidence is sufficient to obtain a conviction and (2) whether prosecuting the case serves a federal interest. If the prosecutor decides not to go forward with the case, the defendant may still be liable for his or her actions in civil court. If the prosecutor chooses to proceed with a criminal action, the prosecutor must demonstrate the likelihood that the defendant’s actions and intent meet the elements of a crime by charging the defendant with a crime through an information or an indictment. For a misdemeanor, the prosecutor must present to the magistrate evidence sufficient to justify prosecution of the defendant. This is

done through a written document called an information, a formal accusation stating the facts and specifying the violation of criminal law. However, for a felony, the prosecutor must present a grand jury with evidence adequate to justify bringing the defendant to trial. If the grand jury agrees that the evidence is adequate, it issues an indictment, a written accusation of the crime allegedly committed by the defendant. Note that the grand jury does not determine guilt. It is simply a group of citizens who consider evidence of criminal conduct presented by the prosecutor and then determine whether there is enough evidence to try the defendant for the crime. In federal cases, a defendant accused of a felony has a constitutional right to a grand jury indictment. However, a felony prosecution may proceed by information if the defendant waives that right. For instance, in a high-profile case in which the defense attorney is trying to work out a deal with the prosecution, the defendant may ask for the case to proceed by information. Federal misdemeanor cases may proceed by indictment or information. Page 130 CASE Nugget Finally, U.S. Supreme Court Holds that the 6th Amendment Requires a Unanimous Verdict Ramos v. Louisiana 140 S. Ct. 1390 (2020) In the United States, the right to a jury trial is fundamental to justice. But are unanimous jury verdicts required to convict? Forty-eight states and the federal government believe they are. Until 2020, however, Louisiana and Oregon convicted felons for serious offenses, even with a 10-2 verdict. This changed in Ramos v. Louisiana, where the Supreme Court held unanimous verdicts are required for serious offense convictions. Delivering the Supreme Court’s opinion, Justice Gorsuch began with the historical reason why Louisiana and Oregon allowed nonunanimous verdicts. Nonunanimous verdicts were endorsed at Louisiana’s 1898 constitutional convention, the purpose of which was to “establish the supremacy of the white race.” The U.S. Senate had passed a resolution to investigate whether Louisiana was excluding Black people from juries. The 10-2 conviction requirement allowed Louisiana to continue convicting Blacks while ostensibly allowing Black jurors. Similarly, Oregon’s nonunanimous verdict can be traced back to the Ku Klux Klan's rise in the 1930s. Both states had racially discriminatory motives. Justice Gorsuch then recounted the meaning of “jury trials” when the Sixth Amendment was written. He noted that by then jury trials implied unanimous verdicts for 400 years. Although the Sixth Amendment does not explicitly require unanimous verdicts, based on the common law and the Founder’s intentions, unanimous verdicts were necessary. Acknowledging the Court’s mistake, Justice Gorsuch and four other justices abrogated Apodaca and Johnson, holding that the Sixth Amendment required unanimous verdicts to convict for serious offenses and that the requirement applied to all states

under the Fourteenth Amendment. If the criminal trial takes place in state court, the defendant may or may not have access to a grand jury. The U.S. Supreme Court has held that indictment by a grand jury is not a fundamental right; thus, states are not required to offer grand juries. About half the states still require felony prosecutions to be initiated by grand jury indictments; most of the rest use information as the method for commencing prosecution. If the grand jury issues an indictment, the defendant appears in court to answer the indictment in a proceeding called the arraignment. At this time, the defendant enters a plea of guilty or not guilty. A defendant may also enter a plea of nolo contendere, whereby the defendant does not admit guilt but agrees not to contest the charges. The advantage of a nolo contendere plea over a guilty plea is that the former cannot be used against the defendant in a civil suit. If the defendant pleads not guilty, his case will be heard before a petit jury, which is a fact-finding jury. At any time, the prosecutor and defendant can make a plea bargain, an agreement in which the prosecutor agrees to reduce charges, drop charges, or recommend a certain sentence if the defendant pleads guilty. Plea bargaining benefits both parties. The defendant gets a lighter sentence, and the prosecution saves time and resources by not trying the case. Businesspeople who commit crimes that affect business often engage in plea bargaining to avoid the publicity associated with a trial and the risk of a severe sentence. Trial Procedure If the case goes to trial and the crime is a felony or a misdemeanor punishable by six months or more in prison, the defendant has a constitutional right to a jury trial. In most states, if the defendant waives the right to a jury trial, the judge will hear the case. When a judge is the fact finder in a case, the trial is called a bench trial. Page 131 In a criminal trial, the prosecutor has the burden of proof and the defendant does not have to prove anything. The burden of proof has two elements: the burden of production of evidence and the burden of persuasion. To meet the burden of production of evidence, the prosecution must produce any tangible evidence and testimony that prove the elements of the crime that the defendant allegedly committed. Along with producing evidence, the prosecution also has the burden of persuasion: The prosecutor must persuade the jury beyond reasonable doubt that the defendant committed the crime. The burden of proof, then, is higher in a criminal case than in a civil case because, in a civil case, the burden of persuasion requires only that the claim is supported by a preponderance of the evidence. The prosecution presents the government’s case first, introducing evidence and examining witnesses to prove beyond a reasonable doubt that the defendant committed the crime. Once the prosecution rests its case, it is the defendant’s turn. The defendant either (1)

can show, through examination of witnesses and introduction of evidence, that the prosecution did not meet its burden of proof or (2) can present an affirmative defense. An affirmative defense is a reason the defendant, even though he or she committed the physical acts alleged by the prosecution, should be excused from responsibility for those actions. Exhibit 6-4 lists some common affirmative defenses. Exhibit 6-4Affirmative Defenses to Crimes Infancy A person who is not yet a legal adult may use this defense to defuse the guilty-mind requirement of a crime. Mistake of fact The defendant says his or her honest and reasonable mistake about a fact relevant to the commission of the crime negates the idea of a guilty mind. Intoxication The defendant says he or she took an intoxicant without awareness of its likely effect, mistook its identity, or took the intoxicant under force. Insanity The defendant had a severe mental illness that substantially impaired the defendant's capacity to understand and appreciate the moral wrongfulness of the act. Duress The defendant says he or she was forced to perform an act against his or her will. Entrapment The defendant would not have committed the crime or broken the law if not induced or tricked into doing so by law enforcement officers. Necessity The defendant was acting to prevent imminent harm, and there was no legal alternative to the action he or she took. Justifiable use of force Use of force was necessary to prevent imminent death or great bodily harm to the defendant or to another or to prevent the imminent commission of a forcible felony. After the jury hears the case, it deliberates and tries to reach a verdict. A jury that is unable to reach a verdict is known as a hung jury. If the jury finds the defendant not guilty, the accused is acquitted and released. If the jury returns a guilty verdict, the judge sets a date for sentencing. Posttrial Procedure Page 132 If the petit jury returns a verdict of not guilty, the government cannot appeal the acquittal. However, if the verdict is guilty, the defendant may appeal the verdict by claiming that a prejudicial error of law occurred at the original trial. If there is no appeal, the defendant will be sentenced after the judge has received additional information relevant to sentencing. Before 1991, sentencing was indeterminate, with judges allowed but not required to engage in free-form fact finding before selecting the appropriate punishment within broad statutory ranges. In 1991, however, there was a shift to determinate sentencing, under which federal sentences are determined largely by sentencing guidelines prescribing a specific range of possible penalties for each crime. Judges are given certain factors to consider in sentencing, such as the defendant's criminal record. Guidelines have also been established for white-collar crimes, once again allowing judges to consider individual factors, such as the company's history of past violations and cooperation with federal

investigators. On April 9, 2015, the United States Sentencing Commission approved new sentencing guidelines for business fraud crimes in response to “longstanding concerns [of judges and lawyers] that the guidelines do not appropriately account for harm to victims, individual culpability, and the offender’s intent.” One of the most significant changes involves how “intended loss,” or the financial harm that was intended to result from the fraud, is understood. It is now interpreted as the loss that the defrauder intended to cause and not necessarily only the loss that was actually caused. In another major change, the financial situation of the victims of the fraud is now being considered. This means that if a person defrauds another person who experienced “financial hardship” as a result of the fraud, such as bankruptcy, harm to the ability to gain credit, substantial losses in investments such as retirement or education, or substantial changes in living arrangements such as having to move into a less-expensive home, harsher sentences may be invoked. Many states have adopted sentencing guidelines similar to the federal guidelines. Exhibit 6-5 summarizes the steps of a criminal procedure. Exhibit 6-5Steps in a Criminal Procedure



Tools for Fighting Business Crime LO 6-5 Describe the laws that attempt to prevent white-collar crime. Although clearly a significant number of business-related crimes can be committed, certain federal laws help fight such crime. Three federal laws that have been somewhat successful in this battle are RICO, the False Claims Act, and the Sarbanes-Oxley Act of 2002. Although these laws are currently extremely powerful white-collar-crime laws, RICO and the False Claims Act were created with different purposes in mind. Sarbanes-Oxley, however, was created specifically to combat white-collar crime. RICO One of the most important tools for fighting white-collar crime is Title IX of the Organized Crime Control Act of 1970: the Racketeer Influenced and Corrupt Organizations (RICO) Act. Although the statute was originally enacted to combat organized crime, in effect it prevents legitimate businesses from serving as covers for racketeering. This statute prohibits persons employed by or associated with an enterprise from engaging in a pattern of racketeering activity. Anyone whose business or property has been damaged by this pattern of racketeering activity can sue to recover treble damages and attorney fees in a civil action. Demonstrating a claim under RICO requires proof of a pattern of racketeering. Courts have defined a pattern as more than one action. Thus, a one-time violator could not be prosecuted under RICO because there could be no pattern as yet. Some courts additionally have found that a pattern requires continued criminal activity over a “substantial” period of time. Although pattern is restricted to more than one act, racketeering has been defined broadly to include almost all criminal actions, such as acts of violence, fraud, bribery, securities fraud, and the provision of illegal goods and services. Therefore, RICO is an extremely effective tool in combating white-collar crimes. In addition to being held civilly liable under RICO, a violator may also be subject to RICO’s criminal penalties. A person found to have violated the act may be subject to a fine of up to $25,000 per violation, imprisonment for up to 20 years, or both. The False Claims Act Since 1986, private citizens have been using the False Claims Act to sue employers on behalf of the government for fraud against the government. For example, an employee in a health care facility might realize that his employer is submitting fraudulent claims to Medicare. The employee can bring a suit against the employer on behalf of the government for fraud against the government. If an employee realizes that their employer is committing fraud against the government, they must first notify the government of their intent to file the case on behalf of the government. If the government chooses to intervene and prosecute the case

itself, with the help of the employee, the citizen would receive 25 percent of the amount recovered. If the government does not opt to get involved, and the citizen continues with the case on behalf of the government, she receives 30 percent. Certainly, an employee who brings a suit against his employer might be worried about retaliation, such as being fired or demoted. Thus, the act provides protection for employees who use the law. If an employer is found guilty of retaliation, the employer may be forced to pay the employee twice the amount of back pay plus special damages. In a 2018 case that was seen as a victory for employers,10 however, the 10th Circuit Court of Appeals ruled that “. . .the False Claims Act’s anti-retaliation provision unambiguously excludes relief for retaliatory acts occurring after the employee has left employment.” Page 134 The biggest reward thus far under the act was the approximately $51 million share that four whistleblowers and their attorneys received for blowing the whistle on a Swiss drug company, Serono, for participating in a marketing scheme that resulted in physicians illegally prescribing over $11.5 million worth of a drug that was paid for by Medicaid. The government settled the case against the company for $704 million. The reward in this case, however, was far above the norm. In 2010, the Justice Department recovered a total of $53.7 billion under the False Claims Act, up from $53.5 billion collected in 2009.11 Although some of these cases might not have been pursued had it not been for the False Claims Act, many people are opposed to the act. Some argue that the whistleblowers are receiving money that should belong to the taxpayers; others say that the act prompts people to refrain from reporting fraud right away but wait until the value of the case grows. Still others complain that the act results in frivolous lawsuits as employees try to find an easy way to make money. Defenders of the False Claims Act point out that the act has led to revelation of some significant cases of fraud that otherwise might have cost the government millions of dollars. They also point out that when an employee does report a fraudulent employer, it becomes very difficult for that employee to get a job in the same field in the future; thus, a significant incentive needs to be offered to convince employees to report such fraud. Page 135 A number of False Claims Act cases have been filed against universities, including an interesting case filed in 2006 against Chapman University. In this case, three faculty members alleged that the institution for years encouraged early dismissals, resulting in many students not getting the minimum classroom training required in several subjects. If the college had admitted that it had engaged in this practice, it would never have been accredited and thus never have received millions of dollars in federal grants and student aid, which the lawsuit claimed it took under false

pretenses.12 The case was ultimately dismissed by a Summary Judgment in 2007, and in 2011, the plaintiff’s appeal to the U.S. Supreme Court was denied. Other False Claims Act cases against universities have been more successful. For example, in 2009, the University of Phoenix settled a False Claims Act suit for $67.5 million for violating federal law that prohibits colleges from paying admissions counselors incentives based on the number of students recruited. The Sarbanes-Oxley Act Unlike RICO and the False Claims Act, the Sarbanes-Oxley (SOX) Act of 2002 was intended to curb white-collar crime. Congress passed Sarbanes-Oxley largely in response to the business scandals of the early 2000s, such as Enron, WorldCom, and Global Crossing, as well as the accounting firm Arthur Andersen. Although much of the act consists of new rules and regulations for accounting firms, part of the act specifically addresses the issue of white-collar crime. Global Context Digital Archive Japan/Alamy Stock Photo Tools for Fighting White-Collar Crime in the UK The UK has a couple tools that it uses to fight white-collar crime. The first is national whistleblower statute, the Public Interest Disclosure Act of 1998 (PIDA), which protects the whistleblower from firing or retaliation if he or she makes a good-faith disclosure based on genuine concerns about crime, civil offenses, miscarriage of justice, danger to health and safety or the environment, and the cover-up of any of these. The emphasis of PIDA is on fixing the problem within the company. The most protected, and preferred, disclosure is one that is made to a manager within the company, so the first step is often to disclose the possible violation to a manager in the company. Sometimes such disclosures are not always advisable or possible, so disclosures to the appropriate ministry are protected, when applicable, as well as disclosures to the appropriate regulatory agency, such as the Health and Safety Executive. Rather than just having a suspicion of wrongdoing, whistleblowers must believe that their allegations are substantially true before disclosing them to a regulator. If the whistleblower reasonably believed that he or she would be victimized for disclosure to the company or regulator, reasonably believed that a cover-up was likely and there was no prescribed regulator, or had already raised the issue internally or with a regulator and no action had been taken, he or she would be protected for a wider disclosure. The whistleblowers do not get monetary rewards, as do whistleblowers in the United States under the False Claims Act. Instead, they may be protected and compensated if action is taken against them. The second tool used in the UK is the unexplained wealth order, a new power that enforcement authorities were given in 2018 to help them fight suspected corruption. The order requires "a person who is reasonably suspected of involvement in, or of being connected to a person

involved in, serious crime" to explain how he obtained his property if his lawful income appears to be insufficient to afford it or face seizure of the property. The first two unexplained wealth orders were issued in 2018 against a woman whose husband, the former chairman of the state-controlled International Bank of Azerbaijan, is serving15 years on fraud and embezzlement charges. She was placed under a court order to explain how she obtained the money to purchase two properties worth £22 million ($29 million) in total or forfeit the properties. She appealed that order multiple times, and in December 2020, she lost her final appeal. The second order was issued over jewelry worth 4 million pounds that was seized from Christie’s Auction House, where she had consigned the jewelry. As of press time, further hearings regarding the jewelry seizures were still scheduled to take place. Sarbanes-Oxley makes it illegal for registered public accounting firms to provide nonaudit services to an audit client. Section 201 of the act specifically names as illegal: Bookkeeping or other services related to the accounting records or financial statements of the audit client. Financial information systems design and implementation. Appraisal or valuation services, fairness opinions, or contribution-in-kind reports. Actuarial services. Internal audit outsourcing services. Management functions or human resources. Broker or dealer, investment adviser, or investment banking services. Legal services and expert services unrelated to the audit. Any other service that the board determines, by regulation, is impermissible. In addition to criminalizing these activities, Sarbanes-Oxley has amended the penalties associated with other white-collar crimes. Under Sarbanes-Oxley, it is now a felony to fail willfully to maintain proper records of audits and work papers for at least five years, and the punishment for not maintaining these records is up to 10 years’ imprisonment. Also, the destruction of documents received updated punishments. The destruction of documents involved in a federal bankruptcy investigation is now a felony, with possible sentences of up to 20 years’ imprisonment. Similarly, the punishment for securities fraud has been increased to 25 years’ imprisonment. In addition, Sarbanes-Oxley has extended the statute of limitations regarding the discovery of fraud. The statute of limitations now extends to two years from the date of discovery of the fraud and five years from the criminal act. The old statute was one year from discovery and three from the act. Also, much like the False Claims Act, Sarbanes-Oxley has taken affirmative steps toward further protecting whistleblowers. State Whistleblower Protection Laws Forty-seven states currently have whistleblower protection laws for either public or private sector employees or both. However, these laws are very different, so it is important for both employers and employees to know the law in their state.

The biggest difference among the states is to whom the violation may or must be reported. In many states, employees in the private sector receive protection from retaliation only if they report the wrongdoing to an external governmental body. Other states take the opposite approach and require the whistleblower to report his suspicions first internally to his supervisors. Almost no states protect employees who choose to go to the media with their reports of employer wrongdoing. Page 136 CASE Nugget Does Whistle-blower Protection under Sarbanes-Oxley Extend to Employees of Private Contractors Serving Public Companies? Lawson v. FMR LLC 134 S. Ct. 1158 (2012) Plaintiffs were former employees of FMR, a group of private companies that contracted to advise or manage mutual funds. As is common in the industry, the mutual funds FMR served are public companies with no employees. Both plaintiffs allege that they blew the whistle on putative fraud relating to the mutual funds and, as a consequence, suffered retaliation by FMR. Each filed suit in federal court. Moving to dismiss the suits, FMR argued that the plaintiffs could state no claim under Sarbanes-Oxley's whistlerblower protection provision because that provision protects only employees of public companies, not employees of private companies that contract with public companies. On appeal from the District Court's denial of FMR's motion to dismiss, the First Circuit reversed, concluding that the term "an employee" under SOX refers only to employees of public companies. The U.S. Supreme Court, however, reversed that decision, giving a broader interpretation of the statute and finding that the act's whistleblower protection includes employees of a public company's private contractors and subcontractors. As the court pointed out, to hold otherwise would be to allow the entire mutual fund industry to insulate itself because virtually all mutual funds are structured so that they have no employees of their own; they are managed, instead, by independent investment advisors. The high court also pointed out that this construction was analogous to the whistle-blower protection given to employees in the aviation industry, in which the term employees includes protection of employees of contractors and subcontractors of air carriers. CASE OPENER WRAP-UP A Questionable Stock Investment The defendant was convicted of one count of securities fraud for his misrepresentations related to stock he sold the hotel investor. He was also convicted one count of mail fraud for sending the stock certificates via Federal Express, and one count of wire fraud for causing the approximately $1,486,323 from the hotel investor to be diverted to his own use through an interstate wire transfer of said funds to a Citibank account the defendant maintained in New York, New York. On appeal, the conviction was upheld in 2014. Had this been an older case, the fact that the certificates were sent via

Federal Express would have been important, but the mail fraud statute has now been amended to specifically include the use of commercial postal services including Federal Express and UPS. Page 137 PRACTICAL TIPS for Business Managers White-collar crime can cripple your business or, at the very least, greatly damage its reputation. Thus, as a business manager, you will want to root out white-collar crime before it becomes a problem. Maintaining an internal audit service with effective and trained auditors can help you keep white-collar crime to a minimum. Provide your employees with proper training so that they understand what is and is not considered ethical and legal activity within your business. Screen potential employees properly and thoroughly to ensure that they have a clean record before appointing them to senior positions.

SUMMARY The Nature and Elements of a Crime The elements of a crime are Actus reus: Wrongful behavior (guilty act). Mens rea: Wrongful state of mind or intent (guilty mind). Crimes are classified into three categories: Felonies: Serious crimes punishable by imprisonment for more than one year or by death. Misdemeanors: Less serious crimes punishable by fines or imprisonment for less than one year. Petty offenses: Minor misdemeanors punishable by small fines or short jail sentences. White-Collar Crime White-collar crimes include Bribery, Extortion, Fraud, Embezzlement and Computer crimes (destruction of computer data, unlawful appropriation of data or services). Corporate Criminal Liability Both corporations, as legal entities, and the corporate officers and managers can be held liable for crimes committed on behalf of the corporation. Criminal Procedure Pretrial procedure: The arrest, booking, first appearance, indictment, and arraignment. Trial procedure: Jury selection, trial with burden of proof on prosecution, jury deliberations, jury verdict, and (if guilty) sentencing hearing. Posttrial procedure: Appeal. Tools for Fighting Business Crime RICO: Prohibits persons employed by or associated with an enterprise from engaging in a pattern of racketeering activity. Anyone whose business or property has been damaged by this pattern of activity can sue under RICO to recover treble damages and attorney fees in a civil action. False Claims Act: Allows employees to sue employers on behalf of the federal government for fraud against the government. The employee retains a share of the recovery as a reward for his or her efforts. Sarbanes-Oxley Act: Criminalizes specific nonaudit services when provided by a registered accounting firm to an audit client; also increases the punishment for a number of white-collar offenses.

Point/Counterpoint As you are considering this issue, you might want to think about statistics that would help you resolve it. Should Insider Trading be Made Legal? YES NO The ban on insider trading is intended to level the playing field for all investors and make the securities market more fair. However, not only does the reality of banning insider trading fail to live up to its intentions, there are several ways that legalized insider trading could actually help the securities market as a whole. For example, as the law stands now, insiders who know that a stock is going to tank in the future can only sit by and do nothing as the price of the stock remains the same and unwitting investors continue to buy in. Take Enron, for example. Enron had been cooking its books for some time before its collapse, and because this practice had remained a secret, the price of Enron's stock remained largely unaffected. The insiders who knew about Enron's shady actions were effectively barred from selling their soon-to-be-worthless stock. If they had been able to sell their stock well before Enron's collapse, surely the market would take notice of the mass selling, and the stock would be much less attractive to investors. Instead of more investors unwittingly buying worthless stock prior to a crash, the price could have gradually decreased to its accurate value due to insider sell-offs, and future investors could have been warned, which would have prevented the whole Enron crisis in the first place. Moreover, white-collar crime tends to affect higher-income individuals, whereas street crime tends to affect lower-income individuals who lack the resources to protect themselves. Street crime disproportionately affects lower-income individuals who cannot afford the private security measures that higher-income individuals use to protect their persons and their property. The law ought to protect those who lack the power to protect themselves. A second reason is that other markets use insider trading and function just fine. The real-estate market is a good example of a market where insider trading is common. For example, say someone is selling a house, and you have insider information that something about the house or the property makes it more valuable than the price that the seller is offering. You pay the seller's price and obtain the house. Both parties walk away happy: the seller sold the house for the price they wanted, and you got the house for a lower price than you thought you would have to pay. A final reason is that it is incredibly hard to make insider trading charges stick. Being that we cannot read the mind of a defendant in an insider trading case, it is almost impossible to know what someone knew and when they knew it. Investigating and prosecuting insider trading is inefficient and highly

resource-consuming. During the 2009 investigation of the Galleon Group, the federal government pored over 14,000 wiretapped phone conversations looking for evidence of insider trading. Often, even the most high-profile insider trading cases end up with next to nothing: after all the noise made in Martha Stewart's insider trading case, she was convicted of obstruction of justice and lying to investigators, not insider trading. The government would be much better off using their resources to detect and prevent large-scale crises such as the Enron crash than going after something as victimless as insider trading. Insider trading can do great harm to investors as well as to the securities market as a whole, and the practice has been made illegal for good reasons. First, insider trading almost necessarily leads to investors with insider information cheating other investors without insider information. If an insider knows that a stock's value is about to skyrocket, he can buy multiple shares for much less than what they are worth and give another investor a bad deal. If an insider knows that a stock's value is about to plummet, he can sell off all of his shares to unwitting investors who are now about to lose a lot of money on their investment. In either case, the insider unfairly profits. The above explanation leads directly into another reason insider trading is illegal: if investors were constantly worried about getting cheated by insider trading, the integrity of the securities market would be damaged, and many investors would be discouraged from participating in the market. Fewer investors means fewer buyers and sellers and, therefore, less money being invested into businesses. A final reason, which is closely tied to the previous reason, is that legalizing insider trading would endanger market transparency and corporate transparency. If an insider comes across nonpublic information, he is likely to hide this information not only from the public but from the corporate directors as well in order to maximize his profits. If the corporate directors are unaware of this information, they cannot provide accurate financial information to the public and the public cannot make well-informed investments. The market simply cannot properly operate if it lacks transparency and is full of trades made on secret information. In insider trading cases, the only people who truly win are the insiders.

Questions & Problems Name and explain the two elements of a crime. Identify the distinguishing features of white-collar crime. List and define the primary affirmative defenses used in criminal cases. List and describe the main types of fraud committed in the business context. What is meant by reading a defendant his Miranda rights, and why are these rights important? Explain the steps of a criminal prosecution. Explain the federal laws that are

currently being used to fight white-collar crime. Jack DeCoster owned Quality Egg, LLC, an Iowa egg production company. Jack's son Peter DeCoster served as the company's chief operating officer. Jack also owned and operated several egg production companies in Maine, and Peter worked at those facilities. In 2008, salmonella enteritidis ("salmonella") tests conducted at the Maine facilities came back positive. Other than conducting the single egg test in April 2009, Quality Egg did not test or divert eggs from the market before July 2010 despite receiving multiple positive environmental and hen test results. The Centers for Disease Control and Prevention estimated that about 56,000 Americans fell ill with salmonellosis in 2010 after consuming contaminated eggs. In August 2010, federal and state officials determined that the salmonella outbreak had originated at Quality Egg's facilities. A criminal investigation was opened, and Jack and Peter pled guilty as responsible corporate officers for introducing adulterated eggs into interstate commerce. The DeCosters now appeal their prison sentences, arguing that they had not known the eggs were contaminated at the time they were shipped. Do you believe the DeCosters were successful in their appeal? Why or why not? Source: US v. DeCoster, 828 F.3d 626 (8th Cir. 2016I Just a typo. Should read 2016). Robert Carr is the founder of Heartland Payment Systems, Inc. Carr was heavily involved in negotiations with Global Payments, Inc. concerning the acquisition of Heartland by Global. During this time, Carr's girlfriend, Katherine Hanratty, frequently expressed her concern regarding her financial security. Carr reassured her by discussing the progress of the negotiations. Later, Carr gave Hanratty a check for $1 million and told her to invest $900,000 in Heartland shares. Hanratty complied and purchased 11,000 shares of Heartland stock. Soon after, Heartland and Global announced their acquisition deal, causing the value of Heartland's stock to soar. Hanratty then consulted with Carr about when to sell the stock. Following this conversation, Hanratty sold all her Heartland stock at once, netting her $250,000 in profits. Eventually, the SEC discovered Hanratty's activity. What do you think the SEC's charges were? Who do you think was held responsible: Carr, Hanratty, or both? Why? Source: SEC v. Robert O. Carr and Katherine M, Hanratty, No. 3:18-cv-01135 (D. Connecticut) (2018). Page 140 After the financial crisis of 2008, Anchor BanCorp Wisconsin (ABCW), and its subsidiaries AnchorBank and Investment Directions, Inc. (IDI) were in dire straits. AnchorBank and ABCW were trying to negotiate an extension for a $116 million loan from U.S. Bank with a large payment due by the end of March 2009. On December 29, 2008, David Weimert, the vice president of AnchorBank and the president of IDI, was instructed to sell commercial properties held by IDI to acquire the cash to pay U.S. Bank in March. Weimart

successfully closed a deal that resulted in $2 million more than he was told to sell for while also reducing IDI’s mortgage liability by $15 million, therefore freeing more money that could be sent to AnchorBank or ABCW. In closing the deal, however, Weimert saw an opportunity to insert himself into the transaction. Weimert convinced the two prospective buyers that he would be a useful partner. Both buyers included a provision having Weimert buy a small percentage of the property in their offer letter. Testimony given at the subsequent trial revealed that Weimert had misled the board of directors that the buyers would not purchase the property unless he was included in the deal. Indeed, Weimert was convicted of five out of six counts of wire fraud on the theory that his actions were part of a scheme to obtain money or property by fraud. Weimert appealed the ruling on grounds that his actions did not rise to the level of fraud. Source: United States v. Weimert, 819 F. 3d 351 (2016). From 2004 to 2010, Edward Weaver was the CEO of Vendstar, a corporation that sold candy-vending machines to approximately 7,000 customers who spent a total of about $62 million on the investments. Although Vendstar’s promotional materials and salespeople represented that the investment opportunities would be lucrative, for the most part, the vending machines would earn Vendstar’s customers almost no money. Customer complaints became so frequent that Weaver assigned a Vendstar employee to respond to those complaints full time. In the end, many customers lost virtually all of their investments in Vendstar. The size of the investments varied, and the most common transaction involved the victim paying $10,000 for a package that included 30 candy-vending machines and an initial supply of candy, although some customers spent significantly more than that. Under the Vendstar scheme, potential customers would respond to Internet or newspaper ads approved by Weaver. Vendstar would mail them a brochure, order form, and certain disclosure documents. The brochure, which Weaver also approved, included claims that the salespeople were “Vendstar vendors themselves” and promised that the investments had “little risk.” Vendstar salespeople would then follow up with customers over the phone. During those phone conversations, salespeople routinely lied to customers, promising them utterly unrealistic earnings and claiming that the investments were sound. Salespeople also falsely stated that they owned their own Vendstar machines, a misrepresentation that encouraged customers to trust them and buy the machines. At trial, victims of the scam testified that those lies influenced their decision to purchase the machines. If customers agreed to purchase the machines, they signed a contract that included the following disclaimers in capital letters: Purchaser understands that seller has no affiliation or financial relationship with professional locating

companies and that seller has no involvement whatsoever in securing retail locations. . . . Purchaser and seller agree that this purchase order contains the entire understanding of the agreement between the parties and there is no reliance upon any verbal representation whatsoever. Seller has not guaranteed any minimum or maximum earnings. . . . It is further acknowledged that no statements, promises[,] or agreements influenced this purchase or are expected other than anything contained in this purchase order. . . . What crime do you think Weaver was convicted of? Weaver appealed this conviction. What do you think his argument on appeal was? Do you think his conviction was upheld? Source: United States v. Weaver, 860 F.3d 90; 2017 U.S. App. LEXIS 10948. Robert Shapiro was the owner and CEO of Woodbridge, a supposed investment firm. Woodbridge's main business model was to solicit money from individuals to invest in "low risk" and "conservative" investments. According to Woodbridge, these investments were tied to real estate owned by third parties and that these third parties would be making interest payments to Woodbridge and the investors. In reality, Shapiro owned all of the investment properties and was perpetrating a Ponzi scheme, using new investors' money to pay off old investors. Shapiro created and controlled a network of more than 270 LLCs to buy and sell the properties to trick investors and cover his tracks. In total, Shapiro and his associates gathered over $1.29 billion in investments from over 9,000 individuals. However, Shapiro was unable to keep up with his own massive scam, and his misdeeds were discovered when Woodbridge filed for bankruptcy. What crime do you think Shapiro would have been convicted of? Why? Source: In re Woodbridge Group of Companies, LLC, 592 BR 761 (2018). Toby Scammel's girlfriend was briefly involved in Disney's acquisition of Marvel in 2009. Scammel bought 659 Marvel options for $5,465 in the days prior to the announcement of the acquisition. Within the nine days following the announcement, Scammel sold all his Marvel shares, amounting to a total of $192,496.61. Although Scammel's girlfriend would mention general facts about a big project she was working on, the couple claimed that she never gave him details about the acquisition. However, he had access to her electronic documents related to the acquisition and had begun piecing together the companies involved and the timing of the acquisition. Scammel's girlfriend had confidential information about the deal, including that Disney would pay $50 per share for Marvel and that the deal would be announced by Labor Day. Scammel claimed that his girlfriend had told him nothing and that he had done nothing wrong; he had frequently been involved in the stock market and was simply trading shares normally as he had done before. The SEC, in its investigation, also learned just before he

purchased many of the Marvel securities, Scammel searched the internet for the terms “insider trading,” “material, non-public information,” and “Rule 10b-5.” What crime do you believe Scammel was charged with? Do you think there was enough evidence to warrant his conviction for that crime? Source: SEC v. Scammel, 2011 WL 3506153 (C.A.C.D. Aug. 11, 2011). On November 11, 2011, the window of Jamie Williams’s house was allegedly broken by someone who then entered through the broken window and removed several items, including a laptop computer. One day after the incident, Williams filed a report, naming Sammie Smith as the perpetrator. At the trial, Williams testified that he saw Smith running away from his house on the night of the burglary. Williams’s neighbor, Dacorious Clark, also testified, stating that on November 11, Smith showed up at his house with a laptop computer tucked into his pants. Smith allegedly tried to sell the computer to Clark. Clark declined the offer but was asked to keep the device anyway. After opening the computer and looking at the login screen, Clark realized that the laptop belonged to Williams, and returned it to him one week after the night of the incident. Smith was the only witness for the defense and testified that he was at a football game on the night of the burglary. According to Smith, he met his cousin and exchanged a bag of marijuana for the computer and then traded the computer with Clark for $60 worth of cocaine. Based on the testimony presented at the trial, what crime do you believe Smith was convicted of? On appeal, do you believe the appellate court found that there was sufficient evidence to convict Smith? Source: Sammie Smith v. State of Mississippi, 150 So. 3d 122 (2014).

Part 1 The Legal Environment of Business CHAPTER 7 Tort Law Page 142 CASE OPENER Plastic Surgeon Defamation Dr. Walter Sullivan was one of several plastic surgeons in Las Vegas whom Julie Jones visited. Jones, an exotic dancer, sought plastic surgery to improve her ability to make money in her profession. After visiting Sullivan for a consultation, she then visited Dr. Joseph Bongiovi, Jr. During her consultation with Bongiovi, Jones mentioned her earlier visit with Sullivan. Bongiovi then told her that a patient of Sullivan’s died the previous week during the same procedure Jones sought. Bongiovi told her the death was the direct result of Sullivan’s negligence. Despite Bongiovi’s allegations, Jones saw Sullivan again and scheduled the surgery with him. Jones did, however, attend a prescheduled appointment with Bongiovi. During the appointment, at Jones’s prompting, Bongiovi

confirmed what he had said before—that Sullivan had recently been responsible for a patient's death during the same procedure Jones sought. On the basis of the confirmation from Bongiovi, Jones called to cancel her surgical appointment with Sullivan. When Sullivan's office manager asked why she was canceling the appointment, Jones said she had been told that Sullivan was under investigation for a patient's death. When Sullivan learned of the cancellation, he called Jones to find out who had made the statements; he was unsuccessful in obtaining a name. After speaking with Sullivan, Jones again called Bongiovi's office to receive confirmation about the allegation. Bongiovi's assistant confirmed that the statements were true. When Sullivan eventually learned the identity of Bongiovi, he filed suit for defamation. According to Sullivan, Bongiovi's statements were slanderous per se. At the conclusion of a trial, a jury found in favor of Sullivan and awarded him $250,000 in compensatory damages and $250,000 in punitive damages. Bongiovi appealed, arguing that the jury should have been instructed that actual malice was the standard because Sullivan was a public figure. Furthermore, Bongiovi argued that the compensatory and punitive damages awarded were exorbitant. What defenses, if any, could Bongiovi have presented to prevent the damage awards? Under which ethical system, if any, should Bongiovi be required to pay damages to Sullivan? Why? Page 143 LEARNING OBJECTIVES LO 7-1 Classify types of torts. LO 7-2 Summarize the intentional torts against persons, property, and economic interests. LO 7-3 Identify the elements that must be proved to win a negligence case. LO 7-4 Recognize the doctrines that help a plaintiff establish a case of negligence. LO 7-5 Recall the defenses to a claim of negligence. LO 7-6 Explain how a party proves a strict-liability case. LO 7-7 Recall the types of damages available in tort cases. As a future business manager, you will likely be involved in a situation in which one party believes he or she has been injured by the actions of another party, in the same way Dr. Sullivan believed he had been injured by Dr. Bongiovi's allegations about the death of one of Dr. Sullivan's patients due to the doctor's negligence. Wrongs such as these are often referred to as torts. A tort is commonly defined as a wrong or injury to another, other than a breach of contract. In fact, tort is a French word meaning "wrong." This chapter first examines the goals of tort law and the three primary classifications of torts. Next, the chapter examines each of the categories of torts. It concludes by discussing damages that may be available in tort cases.

Introduction to Tort Law Chapter 6 introduced criminal law and explained the punishment individuals may receive for committing crimes. Most of the actions that give rise to criminal prosecutions also provide the basis for a tort claim by the victim of the crime. Although the primary objectives of criminal law are to punish wrongdoers and preserve order in society, the primary objective of tort law is to provide compensation for injured parties. Tort law also contributes to maintaining order in society because it discourages private retaliation by injured persons and their friends. After all, we do not want to live in a community where vigilantes with tempers are roaming about, righting some harm they believe has occurred to them. A third objective of tort law is to give citizens a sense that they live in a just society. Our collective sense of right and wrong suggests that someone who creates harm should make things right by compensating those who were harmed. The recognition that one will have to pay for the personal injuries she or he causes may also serve to deter the commission of torts. Although this chapter discusses torts as if they were the same everywhere, tort law is primarily state law, so states may have slightly different definitions of each tort. In describing torts, this chapter uses the definitions common in most states, noting when there seems to be a significant difference in the way certain states define the tort. Despite the public impression of a tort litigation explosion often conveyed by the media, because tort law is state law, no entity regularly compiles and publishes an annual report of the total number of tort cases filed nationwide. And while every year we do see million, and even billion dollar tort verdicts, the average tort case settles for around $53,000, while around 4-5% of tort claims do go to a jury, resulting in a wide range of verdicts. So given what we do know about tort litigation and damages, we know that potential tort liability should concern a competent business manager.

Classification of Torts LO 7-1 Classify types of torts. Torts are most commonly classified as intentional, negligent, or strict-liability torts. Each category differs in terms of the elements needed to prove the tort, the available damages, the available defenses, and the degree of willfulness of the actor. Intentional torts occur when the defendant takes an action intending that certain consequences will result or knowing certain consequences are likely to result. Negligent torts occur when the defendant acts in a way that subjects other people to an unreasonable risk of harm. In other words, the defendant is careless to someone else’s detriment. Finally, strict-liability torts occur when the defendant takes an action that is inherently dangerous and

cannot ever be undertaken safely, no matter what precautions the defendant takes. It is important to remember that when we discuss these classifications, we are referring to their use in the United States. The Chinese legal system, for example, narrowly defines the activities actionable under tort law.

Intentional Torts Intentional torts are the most willful of torts. Intentional torts are predicated on the common element of intent. The intent at issue is not intent to harm but, rather, to engage in a specific act, which ultimately results in an injury, physical or economic, to another. In fact, one does not need to establish a motive when proving liability in an intentional tort case. Moreover, in tort law, it is assumed that people intend what could be considered the normal consequences of their actions. For example, if Rob throws a rock toward a group of people, it would be assumed under the law that he intended to hit someone with the rock and that the person hit would be hurt, regardless of Rob's intention merely to scare the group of people. As a general rule, each specific intentional tort has a set of elements that must be proved to establish the tort, along with specific defenses that can be raised against each tort. However, not all harms intentionally committed will fall neatly into an existing category of torts. Therefore, a general theory of intentional tort liability has been created to aid judges in their decision making. In Section 870 of the Restatement (Second) of Torts, the general theory is explained this way: One who intentionally causes injury to another is subject to liability to the other for that injury, if his conduct is generally culpable and not justifiable under the circumstances. This liability may be imposed although the actor's conduct does not come within a traditional category of tort liability. Intentional torts are divided into the following three categories: (1) torts against persons, (2) torts against property, and (3) torts against economic interests. The following sections discuss a number of specific torts that fall into each category, along with the defenses for each. Intentional Torts Against Persons LO 7-2 Summarize the intentional torts against persons, property, and economic interests. Torts against persons are intentional acts that harm an individual's physical or mental integrity. There are a significant number of these torts. Assault and battery are two of the most common. Imagine that after searching for a parking space for 20 minutes, you finally pull into a spot. However, as soon as you turn off your car, a man who looks like Mike Tyson starts pounding on your car window. He

angrily yells, “You took my spot! If you don’t move your car now, I’m going to hit you so hard you won’t remember what your car looks like!” The man has just assaulted you. An assault occurs when one person places another in fear or apprehension of an immediate, offensive bodily contact. Therefore, in the above example, if you think the man is just joking and you start laughing, no assault has taken place because there is no fear or apprehension. Not only must you feel fear or apprehension, but that feeling must be reasonable under the circumstances. Page 145 An assault is often, but not always, followed by a battery, an intentional, unwanted, offensive bodily contact. Almost any unwanted, intentional contact constitutes a battery. Even contacts that are harmless, if unwanted, are batteries. And even if a touch is intended as a joke, if the reasonable person would be offended, the contact is deemed offensive.1 To return to the example of the parking-space incident, if the man actually hit you, his action would constitute a battery. In contrast, if you both happened to be getting out of your respective cars at the same time and consequently bumped into each other, no battery would have occurred because there was no intentional bodily contact. BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? Recall in the Case Opener that Dr. Sullivan sued Dr. Bongiovi because of the false statement he made. What if, instead, Dr. Sullivan had called Dr. Bongiovi and said, “If you ever tell a potential client a lie like that about me again, I will slit your throat!” Would Dr. Sullivan have committed an assault or battery? Why or why not? A limited number of defenses are available to an action for a battery. A party charged with a battery may argue that the offended party consented to the contact. Consent, as a defense, mitigates the element of unwanted. A person cannot commit a battery if the contact was consented to and therefore wanted. The most common defense to battery is self-defense, responding to the force of another with comparable force to defend oneself. In our parking-space example, if the man took a swing at you and you shoved him to try to keep him from hitting you, causing him to fall backward and hit his head on the street, he would not succeed in a case against you for battery because you could raise the defense of self-defense. To use this defense, you cannot use a greater level of force than is being used against you. A third defense, defense of others, allows you to defend another by using the same degree of force that you could use to defend yourself. A final defense, defense of property, allows you to use reasonable force to defend your property from an intruder. The use of deadly force in defense of property is rarely, if ever, considered justified. The tort alleged in this chapter’s opening case was defamation, which is the intentional publication (communication to a third party) of a false statement harmful to an

individual’s reputation. In addition to the person who publishes a false statement, anyone who republishes, or in any manner repeats, a defamatory statement is also liable for defamation, even if he or she cites the original source of the defamation. If the defamation is published in a permanent form, such as printed in a magazine or newspaper, it is known as libel. Defamation through television and radio broadcasts is also considered libel because the broadcasts are permanently recorded. In the case of libel, general damages are presumed. Thus, the victim would be entitled to compensation for the damages that are presumed to flow from defamation yet are hard to prove, such as the humiliation the victim would feel. If the defamation is made orally, it is slander. To recover damages in a case of slander, the plaintiff must prove special damages; that is, the plaintiff must show specific monetary loss that resulted from the defamatory statements. Although libel is contained in a permanent form, slander, by virtue of being spoken, is not. It is the lack of permanence that gives way to the special damages involved with slander. If the people who heard the slander do not act in a way to cause harm to the slandered person, there is no cause for compensation, which is one of the main goals of tort law. One exception to the requirement of special damages occurs if the false statements constitute slander per se. Slander per se statements are considered so inherently harmful that general damages are presumed. The kinds of statements considered slander per se are claims that an individual (1) has a loathsome, communicable disease (traditionally, venereal disease or leprosy); (2) has committed a crime for which imprisonment is a possibility; (3) is professionally incompetent; or (4) if a woman, has engaged in sexual misconduct. Case 7-1 illustrates how a plaintiff tried to establish a claim for defamation per se based on a Facebook post. The plaintiff unsuccessfully tried two alternative grounds to establish his claim, in part illustrating how difficult it is to prove defamation per se. Page 146 CASE 7-1 AFLALO v. WEINER District Court, Southern District of Florida WL 3235529 (SDFL 2018) FACTS: On June 8, 2017, Eugene Weiner made a post on Isaac Aflalo’s Facebook page. The post read, “Yurim and Isaac took advantage of a old 94plus sick man elder abuse [sic].” Alflalo took umbrage to the post and filed a suit against Weiner, alleging that Weiner’s post constitutes defamation per se. Specifically, Alflalo alleged that the post constituted defamation per se because it charged him with the commission of an infamous crime and subjected him to hatred, distrust, ridicule, or contempt. Weiner filed a motion to dismiss the case. ISSUE: Did Weiner’s Facebook post amount to defamation per se? REASONING: Under Florida law, to assert a claim for defamation —libel or slander—a plaintiff must establish that: "(1) the defendant

published a false statement; (2) about the plaintiff; (3) to a third party; and (4) that the falsity of the statement caused injury to another." A written publication (like a Facebook post) rises to the level of libel per se "if, when considered alone and without innuendo, it (1) charges that a person has committed an infamous crime; (2) tends to subject one to hatred, distrust, ridicule, contempt, or disgrace; or (3) tends to injure one in his trade or profession." Plaintiff alleges that the Statement qualifies as defamation per se on two of the three grounds—it imputes Plaintiff with the commission of an infamous crime and it subjects him to hatred, distrust, ridicule, or contempt. The subject Statement reads: "Yurim and Isaac took advantage of a old 94plus sick man elder abuse [sic]." Because the Statement uses the phrase "elder abuse," Plaintiff alleges that Defendant is imputing Plaintiff with "having committed an act which constitutes the infamous crime of elder abuse under Chapter 825 of the Florida Statutes." Crimes characterized as having an infamous nature are "murder, perjury, piracy, forgery, larceny, robbery, arson, sodomy or buggery." However, if an offense does not fall into one of these categories, only a felony is considered an infamous crime. In Florida, "elder abuse," as defined under Chapter 825 of the Florida Statutes, is categorized as a felony. Here, nothing in the Statement supports the conclusion that use of the phrase "elder abuse" amounts to an accusation of a felony. As such, the Statement does not impute to Plaintiff the crime of elder abuse as defined under Chapter 825 of the Florida Statutes, and therefore it does not qualify as defamation per se under the first ground. Plaintiff also alleges that the Statement rises to the level of defamation per se under the second ground. Plaintiff relies on the court's analysis in Caldwell v. Cromwell-Collier Pub. Co., . . . to argue that even if the Statement does not impute an infamous crime, it subjects him to "hatred, distrust, ridicule, contempt or disgrace. . . .” But whereas in Caldwell a widely circulated newspaper published damaging statements about a sitting governor, here the Defendant wrote a grammatically flawed and incoherent post on his Facebook wall about Plaintiff, a distant relative. Plaintiff has failed to convincingly plead that the Statement, or the circumstances surrounding it (i.e., the parties involved, the medium chosen, the words used), engender the type of hatred, distrust, ridicule, contempt or disgrace that is required to succeed under this prong. DECISION AND REMEDY: Plaintiff’s complaint is DISMISSED without prejudice. SIGNIFICANCE OF THIS CASE: This case demonstrates how difficult it may be to meet the requirements for defamation per se. CRITICAL THINKING What additional facts, had they been present in this case, might have enabled the plaintiff to have been successful in establishing defamation per se? ETHICAL DECISION MAKING Which values

are furthered by the outcome of this case? Page 147 If you say your boss is a tyrant or your roommate is a slob, are you in danger of being sued for defamation? You probably are not because such statements are not really statements of fact; rather, they are opinions, and subjective opinions that cannot be proven are generally not actionable. That distinction between fact and opinion may become more important, as well as perhaps more unclear, as the use of social media continues to expand. Consider, for example, the court's determination that statements made via Twitter were mere opinion in the following Case Nugget. CASE Nugget The Increasingly Important Role of Context in Distinguishing Fact from Opinion Cheryl Jacobus v. Donald J. Trump, Corey Lewandowski, and Donald J. Trump for President, Inc. Manhattan State Supreme Court 2017 NY Slip Op 08625 According to allegations of the plaintiff's complaint taken as fact for purposes of Defendant's motion to dismiss, Plaintiff is a "political strategist and public relations consultant" and frequent commentator on television news channels and other media outlets, offering "political opinion and analysis from the Republican perspective." In May of 2015, she received a message from a Trump campaign employee, asking if she would be interested in becoming the campaign's communications director. She then met with campaign employees Dornan and Lewandowski, who expressed interest in working with her, with Lewandowski asking for her salary requirements. Later that day, Dornan sent a message to Plaintiff, stating that Lewandowski wanted to meet with her again. By email to Lewandowski, Plaintiff provided her salary requirements and indicated her interest in a position with the campaign. On June 9, Plaintiff met with Dornan and Lewandowski again. At this meeting, during a discussion about communications issues, Lewandowski became agitated, loud, and rude, exclaiming that the FOX television network would do whatever the campaign wanted, and telling Plaintiff that she had no idea how FOX works. The meeting ended soon after, and Plaintiff texted Dornan that she could not work with Lewandowski. They had no further meetings. After Trump's formal announcement of his presidential campaign on June 16, 2015, Plaintiff frequently appeared on television as a commentator and posted comments on social media sites, including Twitter, both defending and criticizing Trump. In late January 2017, Plaintiff appeared on a CNN cable news program commenting on the Trump campaign and criticized Trump's debating skills and knowledge. The next day, on an MSNBC program, Lewandowski referenced Plaintiff's comments about Trump, stating that "[t]his is the same person who came to the office on multiple occasions trying to get a job from the Trump campaign, and when she wasn't hired clearly she went off and was upset by that." In February, Plaintiff appeared

once again on a news show criticizing Trump. Later that night, Trump posted the following on Twitter: “Great job on @donlemon tonight @kayleighmcenany @cherijacobus begged us for a job. We said no and she went hostile. A real dummy! @CNN.” A day later, on February 3, 2016, Plaintiff’s then lawyer sent Trump a cease and desist letter. Two days after that, on February 5, 2016, Trump posted the following tweet about plaintiff: “Really dumb @CheriJacobus. Begged my people for a job. Turned her down twice and she went hostile. Major loser, zero credibility!” Many of the president’s followers responded with tweets attacking the plaintiff. The plaintiff sued Trump, Lewandowski, and the campaign for defamation. In a decision that illustrates the increasing difficulty of distinguishing fact from opinion in statements made via social media, the court dismissed the plaintiff complaint, writing that “Loose, figurative or hyperbolic statements, even if deprecating the plaintiff, are not actionable.” The court emphasized the importance of context, stating that, “Words that are challenged as defamatory ‘must be construed in the context of the entire statement or publication as a whole, tested against the understanding of the average reader.’” The court further stated that “defamatory statements advanced during the course of a heated public debate, during which an audience would reasonably anticipate the use of ‘epithets, fiery rhetoric or hyperbole,’ are not actionable.” In its analysis, the court said, “Trump’s characterization of plaintiff as having ‘begged’ for a job is reasonably viewed as a loose, figurative, and hyperbolic reference to plaintiff’s state of mind and is therefore, not susceptible of objective verification. . . . To the extent that the word ‘begged’ can be proven to be a false representation of plaintiff’s interest in the position, the defensive tone of the tweet, having followed plaintiff’s negative commentary about Trump, signals to readers that plaintiff and Trump were engaged in a petty quarrel. Lewandowski’s comments, overall, are speculative and vague, and defendants’ implication that plaintiff was retaliating against them for turning her down, notwithstanding the unmistakable reference to her professional integrity, is clearly a matter of speculation and opinion. Moreover, the immediate context of defendant’s statements is the familiar back and forth between a political commentator and the subject of her criticism, and the larger context is the Republican presidential primary and Trump’s regular use of Twitter to circulate his positions and skewer his opponents and others who criticize him, including journalists and media organizations whose coverage he finds objectionable. . . . Thus, although the intemperate tweets are clearly intended to belittle and demean plaintiff, any reasonable reading of them makes it ‘impossible to conclude that [what defendants said or implied] could

subject [plaintiff] to contempt or aversion, induce any unsavory opinion of [her] or reflect adversely upon [her] work,' or otherwise damage her reputation as a partisan political consultant and commentator." Page 148 One of the important elements of defamation is that the defamatory statement must be damaging to someone's reputation. For example, when a convicted criminal serving three life sentences attempted to sue a journalist for alleged errors in an article detailing his criminal history, the journalist filed a motion to dismiss on grounds that the defendant was libel-proof as a matter of law regarding claims about his criminal background. Upholding the dismissal, the court said the plaintiff's public reputation at the time the articles were published was so diminished with respect to a specific subject (his kidnapping and murder convictions) that he could not be further injured by allegedly false statements on that subject.2 BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? Recall in the Case Opener that Dr. Bongiovi knew Jones was contemplating going to Dr. Sullivan for treatment, and he wanted her business, so he told her negative stories about Dr. Sullivan. What if Dr. Bongiovi had no idea Jones had ever heard of Dr. Sullivan and was telling her the story just as a reminder that no surgery is completely risk-free? The increase in communication over the Internet has presented new questions for the law of defamation to answer. First, does a false statement made over this information network constitute defamation? Second, who can be held liable if defamation does exist? Page 149 The court first attempted to answer these issues in the case of Cubby v. CompuServ.3 In that case, CompuServ was sued because of defamatory statements published on one of the forums available through its online information service. In holding that CompuServ could not be held liable, the court made an analogy between an online information service provider such as CompuServ and bookstores, saying, "CompuServ's CIS product is in essence an electronic, for profit library." The court went on to say that once CompuServ decides to carry a given publication such as a news forum, it has little or no editorial control over that forum. It would therefore be no more feasible for CompuServ to examine every publication it carries for defamatory material than it would be for libraries or booksellers to do so. Since Cubby was decided, the Communications Decency Act of 1996 was passed. Section 230 of this act gives immunity to providers of interactive computer services for liability they might otherwise incur because of material they disseminate but others create. Courts have construed Section 230's liability immunity broadly. In Lemmon v. Snap, Inc., the estates of several teenagers sued Snapchat for causing their deaths. Snapchat has a Speed Filter, which records the speed at which the user is traveling. The suit alleged

that Snapchat’s Speed Filter caused the teenagers to drive at 123 MPH, causing them to lose control and die in a car crash. The court determined the Speed Filter was a content-neutral tool. Snapchat was granted immunity, and the case was dismissed. Blanket immunity may soon become limited. Jane Doe No. 1 v. Backpage.com, LLC sparked outrage when the court ruled that plaintiffs, minor sex-trafficking victims, could not claim compensation against Backpage for facilitating their victimization because Section 230 shielded Backpage’s adult advertisement section. Congress subsequently created an exception for cases involving online sex trafficking in 2018. More recently, online giants like Google and Facebook have faced scrutiny from lawmakers. Both Republican and Democratic legislators agree that Section 230 of the Communications Decency Act is problematic—but not why. On the one hand, Republican politicians feel that social media websites are biased against conservative viewpoints. For instance, YouTube and Twitter banned Alex Jones, a prominent conservative figure. On the other hand, Democratic politicians feel that content providers do not moderate hate speech on online forums enough. Both types of conduct are protected by Section 230. Depending on political winds, social media companies' power to aggregate user-generated content, risk-free, may be coming to an end. A person who is accused of defamation can raise two defenses: truth and privilege. Truth is frequently considered an absolute defense. That is, one cannot be held liable for defamation, regardless of whether damages result, if the statement made was the truth. If I say Bill is a convicted felon, and he is, I have not committed defamation. Under ordinary circumstances, the fact that you thought a statement was true is not a defense. So if I honestly believe Bill is a convicted felon and I tell others he is, but he is not, then I have committed slander. Privilege is an affirmative defense in a defamation action. An affirmative defense occurs when the defendant admits to the accusation but argues that there is a reason he should not be held liable. A privilege is either absolute or conditional. When an absolute privilege exists, one cannot be sued for defamation for any false statements made, regardless of intent or knowledge of the falsity of the claim. Absolute privilege arises in only a limited number of circumstances. The speech and debate clause of the U.S. Constitution gives an absolute privilege to individuals speaking on the House and Senate floors during congressional debate. This privilege exists because Congress wants to get to the truth of matters before it, and if people testifying before Congress had to fear they might be sued, they might be afraid to testify. Absolute privilege also arises during a judicial proceeding. Again, we do not want people to be afraid to testify in court, so we prohibit them from being sued for whatever occurs within the courtroom. As the

following Case Nugget illustrates, the concept of a judicial proceeding can extend beyond a traditional courtroom. COMPARING the Law box DEFAMATION IN TURKEY Defamation cases are generally tried as a civil action in the United States. Indeed, there are no criminal defamation laws at the federal level, and the Supreme Court struck down common law criminal defamation as unconstitutional. Defamation torts are justified by the idea that the private right to free speech is limited by the individual's right to privacy and to not be maligned. This is not the case in Turkey. Under Turkish Criminal Code Article 125, “[a]ny person who attributes an act, or fact, to a person in a manner that may impugn that person’s honour, dignity or prestige, or attacks someone’s honour, dignity or prestige by swearing.” Although defamation is a criminal offense, private individuals must file suit and conduct investigations. If the lawsuit is successful, defendants can be imprisoned from three months to two years. Turkish law allows various defenses based on the insult’s context. Defendants can have the punishment reduced or invalidated if they insulted the plaintiff in response to a civil tort or intentional injury. Plaintiffs should also be careful before deciding to sue: if the court determines the insult was committed reciprocally, it can penalize both parties! Conditional privilege is the second type. Under a conditional privilege, a party will not be held liable for defamation unless the false statement was made with actual malice. A statement is made with actual malice if it is made with either knowledge of its falsity or reckless disregard for its truth. Businesspersons should be most concerned about the conditional privilege that arises with respect to job recommendations. To encourage employers to give honest assessments of their former employees, this privilege protects an employer who makes a false statement about a former worker: The employer will not be held liable as long as the statement was made in good faith and was made only to those who had a legitimate interest in the information being communicated. Page 150 Another conditional privilege is the public figure privilege. Public figures are individuals who are in the public eye, typically politicians and entertainers. Because these individuals have a significant impact on our lives, we want to encourage free discussion about them, so we do not hold people liable for making false statements about them as long as the statements were not made with malice. This privilege does not seem to place an unfair burden on the public figure because such an individual can easily respond publicly to any false claims, given that he or she is already in the public eye and has appropriate outlets available for giving his or her opinion. In the opening scenario, Bongiovi argued on appeal that Sullivan was a public figure by nature of his profession. If Bongiovi could establish that Sullivan was a public

figure, Sullivan would have to show that Bongiovi acted with actual malice while making the statements to the patient. There are those who believe a conditional privilege should apply when the defamatory statement is posted somewhere on the Internet. The reasoning behind application of the privilege in this context is that the person who has been defamed over the Internet can respond to the defamatory remarks in the same forum with minimal effort. Thus, there is less need for the stronger legal protection we ordinarily give to private parties who are defamed. In addition, we want to encourage free expression and the exchange of ideas on the Internet. One way to do so is to allow people to respond openly to criticisms on the Internet. When people are overly concerned about making errors, free exchange is hindered. Relaxing defamation standards in regard to the Internet can encourage people to speak their minds freely. Thus far, however, no such privilege has been established. And when a person is found to have committed defamation on an online bulletin board or website, the damages can be significant. For example, a jury awarded $3 million to a university professor who sued a former student who had accused him of being a pedophile on a website she maintained. Privacy Torts. The fact that truth is an absolute defense to a defamation action does not mean people are free to reveal everything they know. Four distinct torts, collectively called invasion of privacy torts, protect the individual’s right to keep certain things out of public view even if they are true. The four privacy torts are (1) false light, (2) public disclosure of private facts, (3) appropriation for commercial gain, and (4) intrusion on an individual’s affairs or seclusion. False light is closely related to defamation and occurs when publicity about a person creates an impression about that individual that is not valid. It could involve attributing characteristics or beliefs to a person that they do not possess or creating the impression that an individual has taken certain actions they have not taken. Public disclosure of private facts occurs when someone publicizes a private fact about another that a reasonable person would find highly offensive. The individual must have not waived his or her right to privacy. Publication of information about someone’s sex life or failure to pay debts would fall under this tort. Page 151 Appropriation for commercial gain occurs when someone uses another person’s name, likeness, voice, or other identifying characteristic for commercial gain without that person’s permission. Many businesses may choose to use celebrities in their advertisements as a way to appeal to consumers. However, when companies use a celebrity’s likeness or image without his or her consent, they open themselves up to potential litigation and liability. For example, Woody Allen believed that American Apparel appropriated his image when they used an image of him from the

movie Annie Hall in their billboards. Allen sued for $20 million but ended up settling, the day before the case was to go to trial, for $5 million. The final privacy tort is intrusion on an individual's affairs or seclusion, which occurs when someone invades a person's solitude, seclusion, or personal affairs when the person has the right to expect privacy. Examples include wiretapping, using people's passwords to gain access to their email messages, and installing two-way mirrors in a women's dressing room at a gym. You may recall the invasion-of-privacy lawsuit that made headlines in 2016, when a jury awarded television broadcaster Erin Andrews $55 million against a peeping Tom who made a video of her in the nude and posted it on the Internet and the hotel where the invasion of privacy took place. Michael Barnett had asked a hotel employee which room Andrews was staying in and then asked to be placed in the room next door. He removed peepholes in the door, filmed her in the nude with his cell phone, and then posted the video online. The jury allocated 51 percent of the responsibility to Barnett and 49 percent to the hotel, whose employees never told Andrews of Barnett's request to have the room next to hers. One final tort against persons is the tort of intentional infliction of emotional distress. Sometimes called the tort of outrage, intentional infliction of emotional distress occurs when someone engages in outrageous, intentional conduct likely to cause extreme emotional distress to another party. For example, if a person calls his former employer and falsely says her son was just arrested for a double homicide after a botched robbery attempt, most courts would find that behavior outrageous enough to satisfy the first element of the tort. Before damages are awarded in some jurisdictions, the plaintiff must demonstrate injury through physical symptoms directly related to the emotional distress. For instance, in the preceding example, if the employer fainted upon hearing the news, hitting her head on the table and cutting it as she passed out, she would have physical symptoms sufficient to justify a recovery. Other physical symptoms from emotional distress include headaches, a sudden onset of high blood pressure, hives, chills, inability to sleep, and inability to get out of bed. Businesses frequently find themselves sued for this type of tort when they terminate someone's employment or fail to provide a service that a consumer expected. Many of these actions, like the one in Case 7-2, are unsuccessful, primarily because the bar for what is considered outrageous is high, as are the standards for emotional distress. CASE 7-2 AARON OLSON, APPELLANT, v. CENTURYLINK Respondent Court of Appeals of Minnesota No. A12–0884 (UNPUBLISHED OPINION, February 4, 2013) FACTS: On December 14, 2011, appellant Aaron Olson contracted to receive telephone service from respondent, CenturyLink and applied for reduced-rate services that

CenturyLink provides through Minnesota's Telephone Assistance Plan (TAP), a statewide program established to reduce telephone rates for low-income households. The respondent did not apply the reduced rate to Olson's first bill but attached a blank copy of the TAP application. Olson completed the application and mailed it to the respondent, but his next bill also did not reflect a reduced rate. Olson called the respondent and learned that the company had not received his application. Olson then faxed another application to the respondent. A few days later, he contacted the respondent company but could not confirm whether his application had been received. On January 31, 2012, the respondent company disconnected Olson's telephone service. When Olson called the respondent to resolve the dispute, the company representatives repeatedly hung up on him. In April 2012, Olson filed suit, claiming that the respondent company violated the Minnesota Human Rights Act (MHRA) and committed intentional infliction of emotional distress. Because he did not have the money for filing fees, Olson also filed a petition to proceed in forma pauperis (IFP). The district court denied the petition, determining that the action was frivolous because the claims had no basis in law. Olson appealed. ISSUE: When should a defendant be held liable in tort for intentional infliction of emotional distress? REASONING: To prevail on this tort, a plaintiff must establish that the defendant's conduct (1) was extreme and outrageous, (2) was intentional or reckless, (3) caused emotional distress, and (4) the distress was severe. Extreme and outrageous conduct is behavior that is "so atrocious that it passes the boundaries of decency and is utterly intolerable to the civilized community." Furthermore, to hold a party liable in tort for intentional infliction of emotional distress, the emotional distress must be so severe "that no reasonable man could be expected to endure it." In this case, the respondent's acts of failing to process Olson's application, disconnecting his telephone service, and hanging up on him during telephone conversations are not so atrocious that they pass the boundaries of decency. For example, previous case law Langeslag v. KYMN Inc. states that "insults, indignities, annoyances, petty oppressions, and other trivialities do not constitute extreme and outrageous conduct." The evidence provided by the appellant regarding the acts against him by the respondent mirror the acts cited by Langeslag that were previously determined not to constitute extreme and outrageous conduct. DECISION AND REMEDY: The court affirmed the denial of the petition by the district court in favor of the defendant. SIGNIFICANCE OF THE CASE: This case outlines the standards that must be met for a defendant to be held liable in tort for intentional infliction of emotional distress. CRITICAL THINKING Notice that case law can, as in this case, serve as a

restriction on our emotional response to a case. Many of us have had trouble with our phone carrier. The alleged behavior of CenturyLink is at minimum annoying, but case law lays out standards that determine the availability of remedies in cases like these. Reading the case law, describe behavior that CenturyLink would have had to engaged in for the plaintiff to have prevailed. ETHICAL DECISION MAKING What value is the court upholding in finding against the plaintiff? Page 152 Intentional Torts Against Property Because businesses own property, anyone who manages a business should be concerned about torts against property. The most common torts a businessperson might be involved with are trespass to realty, nuisance, trespass to personalty, and conversion. Trespass to Realty The tort of trespass to realty, also called trespass to real property, occurs when a person intentionally (1) enters the land of another without permission; (2) causes an object to be placed on the land of another without the landowner's permission; (3) stays on the land of another when the owner tells him to depart; or (4) refuses to remove something he placed on the property that the landowner asked him to remove. It is no defense for a person to argue that they thought they had a legal right to be on the property or she thought the land belonged to someone else. The intent refers to intentionally being on that particular piece of land. In a recent, unusual case heard in a small claims court in Westchester County, a plaintiff sued the defendant for trespass to realty when the defendant entered the plaintiff's property to serve the plaintiff with a reply affidavit for another legal action. The defendant had previously been barred from entering the plaintiff's property. The plaintiff argued that the defendant could not dictate how legal papers are served. The plaintiff sued for $3,000 in compensatory, nominal, and punitive damages. Although the court ruled that the defendant committed trespass to realty, it awarded only nominal damages in the sum of $1. Page 153 Because guests are welcomed onto one's property, they are not considered trespassers. However, if a guest is asked to leave and refuses, the person immediately becomes a trespasser and no longer maintains a right to be on the property in question. If charges were brought against such a person, that person could not raise the defense that he or she was a guest. Also, when a trespasser is on someone's property, the trespasser is liable for damages they might cause to the property. Furthermore, under common law, a trespasser cannot hold an owner of property liable for damages the trespasser sustains while on the property. However, as of late, courts have been shifting away from this common law rule. Now, courts typically maintain that owners owe a reasonable duty to anyone who may end up on their property. The specifics of the duty vary by jurisdiction as well as by the

status of the parties. In some jurisdictions, it is possible, although rare, for owners to be liable for trespassers who were injured while trying to steal property from the owners. Private Nuisance A private nuisance occurs when a person uses property in an unreasonable manner that harms a neighbor’s use or enjoyment of their property. Using one’s property in a manner that caused the neighbor to be subjected to flooding, vibrations, excessive noise, or smoke could lead to a nuisance claim. A public nuisance occurs when a party acts in a way that endangers the property, health, safety, or welfare of the community. Because a public nuisance is one that affects the public as a whole, actions for public nuisance must be brought by a public official. In late 2017, a number of municipalities in California tried an innovative use of the tort of public nuisance. In almost identical lawsuits, they each sued the big five oil companies, accusing them of creating a public nuisance by ignoring warnings that fossil fuels would cause catastrophic global warming and mounting campaigns to discredit climate change science. They are seeking compensation for the costs of sea walls and other infrastructure needed to protect against climate change.4 Other cities, including Boulder, Colorado, and New York City have filed similar actions. Such litigation, however, is unlikely to be successful. In 2008, a similar suit was filed by an Alaskan village of Kivalina in federal court. A judge dismissed on grounds that the issue was governed by the Clean Air Act. And in a more severe blow to these cases, in 2018, a district court judge dealt a severe blow to this line of cases, dismissing a lawsuit filed by San Francisco and Oakland, stating that, “The problem deserves a solution on a more vast scale than can be supplied by a district judge or jury in a public nuisance case.” Trespass to Personal Property A person commits trespass to personal property, also called trespass to personalty, by temporarily exerting control over another’s personal property or interfering with the true owner’s right to use the property. Under trespass to personal property, the trespasser is responsible for damages caused to the property as well as for damages caused to the owner related to the trespasser’s wrongful possession of the property. For example, if I take someone’s bike from his garage and use it for a week, I have committed trespass to personalty. If I return the bike after it has a flat tire, I will have to compensate the owner for the cost of repairing the tire and any other expenses that resulted from my having the bike for a week. Also, if the bike was the only means the person had for getting to work, I would be responsible for the person’s lost wages resulting from the missed work, because I took the person’s means of transportation. Page 154 Conversion Conversion occurs when a person permanently removes personal property from the owner’s possession and control. When conversion occurs, the true

owner can no longer regain the property. The owner usually recovers damages for the full value of the converted item plus any additional damages that resulted from the loss. It is not a defense to conversion for a person to argue that she believed she had a legal claim to the goods. For example, if Brittany accidentally takes Melvin's suitcase, believing it to be hers, and then loses it, she is still liable for conversion. Moreover, the possession of stolen goods also makes a person liable for conversion. Therefore, buying goods in good faith without knowledge of any impropriety also is not a defense to conversion. Even if a person bought the goods believing the purchase was legal, the person with the stolen goods is liable to the legal owner of the goods. An illustration of conversion comes from a recent case heard in the Westchester County Supreme Court. An amateur race car driver left her race car at a service station. While the car was in the possession of the service station, an employee of the station with a known drinking problem apparently drove the car, wrecked it, and totally destroyed it. The car could never be returned in the condition it was in when brought to the station. The owner sued for conversion and recovered the value of the car in damages. Intentional Torts against Economic Interests All businesspersons should be familiar with the torts against economic interest. The five most common torts against economic interests, frequently referred to as "business torts," are disparagement, intentional interference with contract, unfair competition, misappropriation, and fraudulent misrepresentation. The first tort, disparagement, is similar to defamation, but it is a business' or product's reputation that has been tarnished. The plaintiff in a disparagement case must prove that the defendant published a false statement of a material fact, about the plaintiff's product or service, that resulted in a loss of sales. When such statements are criticisms of the quality, honesty, or reputation of the business or product, the tort is sometimes called slander of quality (if spoken) or trade libel (if in printed form). If the statements relate to the ownership of the business property, the term slander of title is used. Damages for disparaging are ordinarily based on a decrease in profits that can be linked to the publication of the false statement. An alternative, although less common, way to prove damages is to demonstrate that the plaintiff had been negotiating a contract with a third party but the third party lost interest shortly after the publication of the false statement. The profits the plaintiff would have made on the contract would be the damages. Some interesting variations of the tort of disparagement have developed. For example, in 2007, California became the thirteenth state to recognize the tort of food disparagement, which critics call veggie libel. Such laws provide ranchers and farmers with a cause of action when

someone knowingly makes false, damaging statements about a food product. The California law was drafted in response to an incident during 2006 in which Taco Bell executives wrongly identified green onions grown at Boskovich Farms in Oxnard as the source of an E. coli outbreak that sickened 70 of the fast-food chain’s customers. A second tort against economic interests is the tort of intentional interference with contract. To bring a claim of intentional interference with contract successfully, the plaintiff must prove that (1) a valid and enforceable contract between the two parties existed; (2) the defendant party knew of the existence of the contract and its terms; (3) the defendant intentionally undertook steps to cause one of the parties to breach the contract; and (4) the plaintiff was injured as a result of the breach.5 Page 155 When a contract exists, clear liability is placed on third parties for inducing a party to the contract to breach the contract. However, when a prospective contract exists, a third party might be liable for inducing a party to pull out of the contract before it is formed. Because the essence of business involves competition, simply offering a better deal is not enough to create liability when a prospective contract exists. However, if a party uses illegal means to cause another party not to enter into a contract, the party who acted illegally is liable for interfering with contractual relations.6 The most common situation involving intentional interference with a contract in the business context occurs when one employer tries to lure an employee away from another employer. Liability in such a situation, however, is limited to when the employee has a contract for a set period of time and the prospective employer actually knows of the contract. When a third party interferes with a contract, injured parties may recover damages for what was directly lost through the breached contract. They may also recover any losses suffered related to the breached contract, in addition to damages for emotional distress and harm to reputation.7 A third tort against economic interests, unfair competition, exists because of American views about the purpose of a business. Americans believe a business is intended to make a profit, and the law protects businesses acting on this profit motive. Therefore, when someone enters a business with the sole intent of driving another firm out of business, the law punishes this act as unfair competition. For example, if there is only one jewelry store in town, Mark cannot come in and set up a store that makes no profits, just to drive the other store out of business so that an acquaintance of his can then move in and open up a legitimate jewelry store once the competition has been eliminated. A fourth tort against economic interests is fraudulent misrepresentation, which occurs when one uses intentional deceit to facilitate personal gain. To establish that a fraudulent misrepresentation exists, a party must demonstrate all the

following: A party knowingly, or with reckless disregard for the truth, misrepresented material facts and conditions. The party intended to have other parties rely on the misrepresentations. The injured party reasonably relied on the misrepresentations. The injured party suffered damages because of relying on the misrepresentations. A direct link exists between the injuries suffered and a reliance on the misrepresentations.8 As in the criminal act of fraud, in the civil act of fraudulent misrepresentation, a party materially misrepresents something and thereby causes another party to suffer damages. Typically, fraudulent misrepresentation applies only to the misrepresentation of material facts. However, when a party with expert knowledge regarding a specific matter states an opinion, any party reasonably relying on the statement, although it is an opinion and not fact, may recover damages under the tort of fraudulent misrepresentation. CASE Nugget The Wrong State of Mind to Commit Fraud Paraflon Investments Ltd. v. Fullbridge, Inc. No. CV 16-12436-RGS, 2019 WL 3759522 (D. Mass. Aug. 9, 2019), aff'd, 960 F.3d 17 (1st Cir. 2020) One of the elements of false representation is that the defendant knowingly, or with reckless disregard for the truth, misrepresented material facts and conditions. This is important to note because unless the plaintiff can prove the defendant had the wrong state of mind, they cannot win the suit. A reasonable mistake is not enough for the plaintiff to claim fraudulent misrepresentation, as this case shows. Fullbridge, Inc., is a Delaware corporation founded by two Harvard Business graduates that provides training to college graduates and young professionals to prepare them for the workplace. In 2014, Fullbridge responded to several Requests for Proposals (RFPs) issued by Takamol, a royal subsidiary in Saudi Arabia. Fullbridge managed to win funding and contracts to design and implement a training program for Wave 1 and Wave 2. In both Waves, Takamol did not formalize the paperwork until a month before the project was to be completed. Fullbridge won another RFP for Wave 3 in 2015. This was Fullbridge's big break, as the contract would have awarded $40 million. However, Fullbridge was strapped for cash and opened a D-1 financing round. Fullbridge also reached out to Paraflon Investments, Ltd., a previous investor. It mailed a copy of an investor presentation to Paraflon, including statements that Fullbridge had won a $40 million contract with Takamol. Paraflon invested $750,000. Unfortunately, Takamol backed out of the agreement, leaving Fullbridge adrift without the expected $40 million. Paraflon sued Takamol for fraudulent misrepresentation. After a bench trial, the district court found that Fullbridge had not acted with intent to deceive or with reckless disregard for the truth. The court noted even though Takamol had delayed signing the contract with Fullbridge, it had

given Fullbridge multiple assurances that the deal was still on and the Wave 3 RFP was “moving in the right direction.” Moreover, Fullbridge knew from Wave 1 and Wave 2 that Takamol expected “performance first and paper[work] later.” Finally, the court stated that even though Fullbridge was financially struggling, that fact does not support an inference that it purposely or recklessly misled Paraflon. Fullbridge might have engaged in wishful thinking when it hoped the $40 million contract would come through. That was not sufficient to constitute knowing or reckless disregard of the truth. Accordingly, the judge dismissed the case.

Negligence LO 7-3 Identify the elements that must be proved to win a negligence case. Negligence is behavior that creates an unreasonable risk of harm to others. Unlike intentional torts, which result from a person willfully taking actions that are likely to cause injury, negligent torts involve the failure to exercise reasonable care to protect another’s person or property. Sometimes, however, harm occurs because an individual suffers an unfortunate accident, an incident that simply could not be avoided, even with reasonable care. For example, suppose Jonathan is driving on the highway when he suffers a stroke. Because of the stroke, he crashes into two other vehicles. He is not liable for damages caused by the accident because he was not negligent. Yet if Jonathan had some type of warning that the stroke was going to occur, he might be liable for the accident. To win a negligence case, the plaintiff must prove four elements: (1) duty, (2) breach of duty, (3) causation, and (4) damages (see Exhibit 7-1). A plaintiff who cannot establish all four of these elements will be denied recovery. Exhibit 7-1Elements of Negligence To prove negligence, a plaintiff must demonstrate Duty Breach of duty Causation—actual and proximate Damages Duty The plaintiff must first establish that the defendant owes a duty to the plaintiff. In some particular situations, the law specifies the duty of care one individual owes to another. In most cases, however, the courts use the reasonable person standard to determine the defendant’s duty of care. The reasonable person standard is a measurement of the way members of society expect an individual to act in a given situation. To determine the defendant’s duty of care, the judge or jury must determine the degree of care and skill that a reasonable person would exercise under similar circumstances. The judge or jury then uses this standard to evaluate the actions of the individual in the case. Page 157 When courts attempt to determine whether a reasonable

person would have owed a duty to others, they consider four questions: How likely was it that the harm would occur? How serious was the potential harm? How socially beneficial was the defendant's conduct that posed the risk of harm? What costs would have been necessary to reduce the risk of harm? In many situations, it is far from clear what a reasonable person would do. For example, if a reasonable person saw an infant drowning in a shallow swimming pool, what would she do? In most situations like this one, the law holds that individuals have no duty to rescue strangers from perilous situations. In some cases, however, the courts hold that individuals have a duty to aid strangers in certain types of peril. For example, if Sam negligently hits Janice with his car and, as a result, Janice is lying in the street, Sam has a duty to remove her from that dangerous position. Similarly, employers have a special duty to protect their employees from dangerous situations. The courts generally hold that landowners have a duty of care to protect individuals on their property. Similarly, businesses have a duty of care to customers who enter business property. It is important, therefore, for future business managers to be knowledgeable about this duty. Businesses should warn customers about risks they may encounter on business property. Some risks, however, are obvious, and businesses need not warn customers about them. For example, a business need not inform customers that they could get a paper cut from the pages of a book. The courts generally hold that businesses have a duty of care to protect their customers against foreseeable risks about which the owner knew or reasonably should have known. For example, in Haywood v. Baseline Construction Company, a woman who tripped over lumber on the front porch of the House of Blues restaurant in Los Angeles sued for negligence. The business's attempt to warn customers by marking the lumber with yellow construction tape was insufficient to avoid the determination of negligence; the woman was awarded $91,366 in damages. The liability of businesses grew out of the traditional common law, under which the duty of owners and occupiers of real property depends primarily on the status of the injured party. The injured party may be an invitee, a person who enters another's premises as a result of an express or implied invitation of the owner for their mutual benefit, with a business invitee being one who is invited onto the property for the purpose of doing business; a licensee, a person who enters another's premises with the occupier's consent for his or her benefit alone; or a trespasser, one who is on the property without the owner's or occupier's permission, as described earlier in this chapter. Under this approach, the owner owes the greatest duty to the invitee, a duty to inspect the premises to ensure that they are reasonably safe and to warn of any hidden dangers. The owner has a duty to

a licensee to warn of any hidden dangers of which he knows but has no affirmative duty to inspect for hidden problems. The owner owes no duty to trespassers except to do them no intentional harm. Page 158 In 1968, however, the California Supreme Court rejected this rigid division,9 substituting a general duty of reasonable care in its place, under which a duty of reasonable care is owed any entrant onto the land, regardless of status. More than 25 states have now moved to this standard, with a few using this standard for both the invitees and the licensees, while maintaining the traditional approach to trespassers. The trend is toward the use of this unitary standard, but given the lack of uniformity among the states, it is important to know which approach is being used by the state in which you live and do business. E-Commerce and the Law Negligence on the Internet A commonly offered explanation for the increasing occurrence of violence is the increased violence portrayed in the media. Some plaintiffs try to hold owners of certain websites liable under negligence theories for violent acts committed by teenagers. For example, in James v. Meow Media, a 14-year-old boy took six guns to school and shot three of his classmates to death. The parents of the deceased classmates brought suit against several Internet websites and the creators and distributors of various video games. The parents argued that these defendants had a duty of ordinary care to the slain girls. The courts have been consistent, however, in finding that it was not foreseeable that a boy who played certain video games and viewed certain websites would murder three of his classmates. In similar cases, courts have ruled that defendants (such as website owners, creators and distributors of video games, and directors and producers of movies) do not have a duty to protect a person from the criminal acts of a third party unless there is a special relationship that requires the defendant to act with that duty. Although it appears that website owners, manufacturers, and producers will not be held liable, plaintiffs continue to bring suits against these groups of people. Can you think of an argument for why these groups of people might owe a duty of care to these plaintiffs? Professionals have more training than ordinary people. Thus, when professionals are serving in their professional capacity, courts generally hold that they have a higher duty of care to clients than does the ordinary person. A professional cannot defend against a negligence suit by claiming ignorance of generally accepted principles in their field of expertise. Clients who feel that they have suffered damages as a result of a professional’s breach of duty of care can bring a negligence case against that person. These actions are frequently referred to as malpractice cases. Breach of Duty Once the plaintiff has established that the defendant owes them a duty of care, they must prove that the defendant’s conduct

violated that duty. This violation is called a breach of duty. For example, the driver of an automobile owes the other passengers in the car a duty of care to obey traffic signs. Failure to stop at a stop sign violates the duty to follow traffic signs and therefore breaches this duty of care. Causation Causation is the third element of a successful negligence claim, and it has two elements: actual cause and proximate cause. The plaintiff must prove both elements of causation to be able to recover damages. The first element, actual cause (also known as cause in fact), is the determination that the defendant's breach of duty resulted directly in the plaintiff's injury. The courts commonly determine whether a breach of duty actually caused the plaintiff's injury by asking whether the plaintiff would have been injured if the defendant had fulfilled his or her duty. If the answer is no, then the actual cause of the plaintiff's injury was the defendant's breach. Actual cause is sometimes referred to as but-for causation because the plaintiff argues that the damages suffered would not have occurred but for (except because of) the actions of the defendant. Proximate cause, sometimes referred to as legal cause, refers to the extent to which, as a matter of policy, a defendant may be held liable for the consequences of their actions. In most states, proximate cause is determined by foreseeability. Proximate cause is said to exist only when both the plaintiff and the plaintiff's damages were reasonably foreseeable at the time the defendant breached their duty to the plaintiff. Thus, if the defendant could not reasonably foresee the damages that the plaintiff suffered as a result of their action, the plaintiff's negligence claim will not be sustained because it lacks the element of proximate causation. Page 159 You must be able to foresee that either the plaintiff himself or herself or a person in the plaintiff's position would be hurt. If you are running a red light, it is foreseeable that a person will be crossing with the light. If you hit a person crossing with the light, we say the person hit was foreseeable. If it makes more sense, we could say "both a person in the plaintiff's position" and the "plaintiff's damages," but most people refer simply to "the plaintiff and the plaintiff's damages." For example, if a defective tire on a vehicle blows out, it is foreseeable that the driver may lose control and hit a pedestrian. It is not foreseeable, however, that the pedestrian may be a scientist carrying a briefcase full of chemicals that may explode on impact, causing a third-floor window to shatter, injuring an accountant at a desk. In most states, the accountant would not succeed in a suit against the tire manufacturer for negligence. The tire failure is not considered a proximate cause of the accountant's injury because the contents of the pedestrian's briefcase were highly unusual. The pedestrian, however, would be eligible to recover damages from the tire manufacturer

because hitting a pedestrian is a foreseeable consequence of tire failure. Thus, the defect in the tire is a proximate cause of the pedestrian's injury. Palsgraf v. Long Island Railroad Company is a well-known case in which the majority opinion set forth the rule of foreseeability in determining proximate cause. The dissent, however, set forth an alternative definition of proximate cause that is accepted today in a small minority of states. Courts following the minority definition do not distinguish actual cause from proximate cause. In these states, if the defendant's action constitutes an actual cause, it is also considered the proximate cause. Therefore, in these few states, both the pedestrian-scientist and the third-floor accountant would be able to recover damages from the tire manufacturer in the previous example. Damages Damages are the final required element of a negligence action. The plaintiff must have sustained compensable injury as a result of the defendant's actions. Because the purpose of tort law is to compensate individuals who suffer injuries as a result of another's action or inaction, a person cannot bring an action in negligence seeking only nominal damages. Rather, a person must seek compensatory damages, or damages intended to reimburse a plaintiff for her or his losses. In typical negligence cases, courts rarely award punitive damages or exemplary damages, which are imposed to punish the offender and deter others from committing similar offenses. Instead, courts usually award punitive damages in cases in which the offender has committed gross negligence, an action committed with extreme reckless disregard for the property or life of another person. CASE 7-3 TOM BONACCI AND BARRIE BONACCI v. BREWSTER SERVICE STATION, INC. Supreme Court, Westchester County 2016 NY Slip Op 26331 (2016) FACTS: Tom Bonacci took his Jeep into Brewster's Service Station, where he was invited by a serviceman, Gebing, to place himself under the vehicle to point out where he (Bonacci) believed the problem existed with the exhaust system. He was under the vehicle a matter of seconds when the vehicle dropped, injuring both men who were under the Jeep. According to another employee, the lift was under Gebing's control when the arm pulled out of the pivot arm and the Jeep fell off the lift. REASONING: The following three-part test applies to determine whether res ipsa loquitur is applicable: (1) the event must be of a kind which ordinarily does not occur in the absence of someone's negligence; (2) it must be caused by an agency or instrumentality within the exclusive control of the defendant; (3) it must not have been due to any voluntary action or contribution on the part of the plaintiff (internal citations omitted). The application of the three-part test shows that res ipsa loquitur is appropriate in this case. As to the first criteria, given common experience, it would seem that the Jeep's falling from the lift occurred due to

someone’s negligence. As to the second criteria, control of the instrumentality, there is no doubt that the lift, together with the placement of the Jeep on it, and its elevation, was solely within the control of defendant’s employee, who was working within the scope of his employment. As to the third criteria, there is no conduct on the part of plaintiff, other than his accepting the invitation by defendant’s employee to join him under the elevated vehicle, from which it can be argued that plaintiff contributed to the accident. CONCLUSION AND REMEDY: In light of the applicability of res ipsa loquitur, defendant’s motion for summary judgment is dismissed, and plaintiff’s motion for partial summary judgment of the issue of liability is granted. SIGNIFICANCE IF THE CASE: The case illustrates how the doctrine of res ipsa loquitur can be applied. CRITICAL THINKING What evidence do you believe the defendant could have presented that might have prevented the plaintiffs from successfully using the doctrine of res ipsa loquitur? Why would this evidence have helped them? ETHICAL DECISION MAKING Which stakeholders’s interests were furthered by the use of res ipsa loquitur?

Plaintiff’s Doctrines LO 7-4 Recognize the doctrines that help a plaintiff establish a case of negligence. The plaintiff has the burden of proving all four elements of a negligence case. Direct evidence of negligence by the defendant, however, is not always available. For example, there may have been no witnesses to the negligent conduct, and other evidence may have been destroyed. Therefore, two doctrines have been adopted by courts to aid plaintiffs in establishing negligence claims: res ipsa loquitur and negligence per se. Res Ipsa Loquitur Res ipsa loquitur literally means “the thing speaks for itself.” The plaintiff uses this doctrine to allow the judge or jury to infer that, more likely than not, the defendant’s negligence was the cause of the plaintiff’s harm, even though there is no direct evidence of the defendant’s lack of due care. To establish res ipsa loquitur in most states, the plaintiff must demonstrate that The event was a kind that ordinarily does not occur in the absence of negligence. Other responsible causes, including the conduct of third parties and the plaintiff, have been sufficiently eliminated. The indicated negligence is within the scope of the defendant’s duty to the plaintiff. Proof of these three elements does not require a finding of negligence, however; it merely permits it. Once the plaintiff has demonstrated these three elements, the burden of proof shifts to the defendant, who must prove that he was not negligent to avoid liability. Page

161 One of the earliest uses of res ipsa loquitur was the case of Escola v. Coca Cola.10 In that case, the plaintiff, a waitress, was injured when a bottle of Coca-Cola that she was removing from a case exploded in her hand. From the facts that (1) bottled soft drinks ordinarily do not spontaneously explode and (2) the bottles had been sitting in a case, undisturbed, in the restaurant for approximately 36 hours before the plaintiff simply removed the bottle from the case, the jury reasonably inferred that the defendant's negligence in the filling of the bottle resulted in its explosion. The plaintiff therefore recovered damages without direct proof of the defendant's negligence. Plaintiffs in numerous accident cases have subsequently used the doctrine when there has been no direct evidence of negligence. The defendant's best response to this doctrine is to demonstrate other possible causes of the accident. Case 7-3 illustrates the use of this doctrine. Negligence per Se Negligence per se (literally, "negligence in or of itself") is another doctrine that helps plaintiffs succeed in negligence cases. Negligence per se applies to cases in which the defendant has violated a statute enacted to prevent a certain type of harm from befalling a specific group to which the plaintiff belongs. If the defendant's violation causes the plaintiff to suffer from the type of harm that the statute intends to prevent, the violation is deemed negligence per se. The plaintiff does not have to show that a reasonable person would exercise a certain duty of care toward the plaintiff. Instead, the plaintiff can offer evidence of the defendant's violation of the statute to establish proof of the negligence. For example, if Ohio passes a statute prohibiting the sale of alcohol to minors, and a minor runs a red light and kills two pedestrians while driving under the influence of alcohol sold to him illegally, the liquor store's violation of the statute prohibiting the sale of alcohol to minors establishes negligence per se on the part of the store. The families of the pedestrians do not need to establish that a reasonable person would have a duty not to sell alcohol to a minor. The Case Nugget provides another illustration of negligence per se.

Defenses to Negligence LO 7-5 Recall the defenses to a claim of negligence. The courts's doctrines of res ipsa loquitur and negligence per se help the plaintiff in a negligence case, but the courts permit certain defenses that relieve the defendant from liability even when the plaintiff has proved all four elements of negligence. Defendants can successfully rebut negligence claims with contributory negligence, comparative negligence, assumption of the risk, and other special negligence defenses. Contributory Negligence Contributory negligence, a defense once available in all states but replaced

today in some states by the defense of comparative negligence (discussed in the next section), applies in cases in which both the defendant and the plaintiff were negligent. The defendant must prove that (1) the plaintiff's conduct fell below the standard of care needed to prevent unreasonable risk of harm and (2) the plaintiff's failure was a contributing cause of the plaintiff's injury. How can defendants use contributory negligence in a case? Some defense lawyers argue that if a plaintiff involved in a car accident failed to wear a seat belt, that failure constitutes contributory negligence because that action contributed to the injuries. If the defendant successfully proves contributory negligence, no matter how slight the plaintiff's negligence, the plaintiff will be denied any recovery of damages. Because this defense seems unfair, many states have adopted the last-clear-chance doctrine. This doctrine allows the plaintiff to recover damages despite proof of contributory negligence as long as the defendant had a final clear opportunity to avoid the action that injured the plaintiff. For example, suppose that Samantha and Nicole, in their cars, are facing each other while stopped at a red light. The light turns green, and Nicole starts to turn left at the intersection. Samantha sees Nicole start to turn, but she still continues to travel straight through the intersection and crashes into Nicole's car. Although Samantha had the right-of-way at the intersection, she could have avoided hitting Nicole's car by braking or swerving. Thus, according to the last-clear-chance doctrine, Nicole could recover damages. Page 162 Comparative Negligence Most states have replaced contributory negligence with comparative negligence because the adoption of the last-clear-chance doctrine still left many situations in which an extremely careless defendant can cause a great deal of harm to a plaintiff who is barred from recovery due to minimal contributory negligence. There are two forms of comparative negligence: pure and modified. According to a pure comparative negligence defense, the court determines the percentage of fault of the defendant. The defendant is then liable for that percentage of the plaintiff's damages. Courts calculate damages according to modified comparative negligence in the same manner, except that the defendant must be more than 50 percent at fault before the plaintiff can recover. Twenty-eight states have adopted modified comparative negligence, 13 have adopted pure comparative negligence, and 9 have adopted contributory negligence. Every state has adopted one of these three defenses. Thus, the parties to a negligence suit cannot choose among them. Assumption of the Risk Another defense available to defendants facing negligence claims is called assumption of the risk. To use this defense successfully, a defendant must prove that the plaintiff voluntarily and unreasonably encountered the risk of the actual harm

the defendant caused. In other words, the plaintiff willingly assumed as a risk the harm that was suffered. There are two types of this defense. Express assumption of the risk occurs when the plaintiff expressly agrees (usually in a written contract) to assume the risk posed by the defendant's behavior. In contrast, implied assumption of the risk means that the plaintiff implicitly assumed a known risk. The most difficult part of establishing this defense is showing that the plaintiff assumed the risk of the actual harm suffered. A 1998 case against the Family Fitness Center illustrates an unsuccessful attempt to use assumption of the risk as a defense against a negligence claim.11 In that case, the plaintiff was injured when a sauna bench on which he was lying collapsed beneath him at the defendant's facility. The trial court granted summary judgment in favor of the defendant on the basis of assumption of the risk. The plaintiff had signed a contract that included the following provision: "Buyer is aware that participation in a sport or physical exercise may result in accidents or injury, and Buyer assumes the risk connected with the participation in a sport or exercise and represents that Member is in good health and suffers from no physical impairment which would limit their use of FFC's facilities." The appellate court overturned the trial court's decision because the type of injury the plaintiff suffered was not the type of risk he had assumed. The court held that anyone signing a membership agreement could be deemed to have waived any hazard known to relate to the use of the health club facilities, such as the risk of a sprained ankle due to improper exercise or overexertion, a broken toe from a dropped weight, injuries due to malfunctioning exercise or sports equipment, or injuries from slipping in the locker room shower. No patron, however, could be charged with realistically appreciating the risk of injury from simply reclining on a sauna bench. Because the collapse of a sauna bench, when properly used, is not a known risk, the court concluded that the plaintiff did not assume the risk of this incident as a matter of law. Special Defenses to Negligence Many states have additional ways to defend against a claim of negligence. For example, laws in some states hold that people in peril who receive voluntary aid from others cannot hold those offering aid liable for negligence. These laws, commonly called Good Samaritan statutes, attempt to encourage selfless and courageous behavior by removing the threat of liability. The defendant in a negligence suit can also avoid liability by establishing a superseding cause. A superseding cause is an unforeseeable event that interrupts the causal chain between the defendant's breach of duty and the damages the plaintiff suffered. For example, suppose Jennifer is improperly storing ammonia in her garage when a meteor strikes her garage, spilling the ammonia into a stream nearby. Will, living downstream, drinks

water from the stream and becomes dangerously ill. Because the meteor was unforeseeable, Jennifer is not liable for Will’s injuries, even though she breached her duty of care to Will. Superseding causes allow the defendant to avoid liability because they are evidence that the defendant’s breach of duty was not the proximate cause of the plaintiff’s injuries. In other words, superseding causes disprove the causation element necessary to sustain a negligence claim.

Strict Liability LO 7-6 Explain how a party proves a strict-liability case. Strict liability is liability without fault. The law holds an individual liable without fault when the activity engaged satisfies three conditions: (1) it involves a risk of serious harm to people or property; (2) it is so inherently dangerous that it cannot ever be safely undertaken; and (3) it is not usually performed in the immediate community. Instead of banning such activities, the law allows people to engage in these activities but holds them liable for all resulting harm. Inherently dangerous activities include dynamite blasting in a populated area and keeping animals that have not been domesticated. If an animal has shown a vicious propensity, strict liability applies and the owner of the animal is responsible for any injuries suffered in an attack by the animal. An individual who keeps an animal that has shown vicious propensity has a duty to warn and protect individuals who come into contact with the animal. Today, the theory of strict liability is used most commonly when the plaintiff is claiming to have been injured by a product that was unreasonably dangerous.

Damages Available in Tort Cases LO 7-7 Recall the types of damages available in tort cases. There are three types of damages available in tort cases: compensatory, nominal, and punitive (see Exhibit 7-2). You will see this system of classifying damages again when we talk about damages in other contexts, such as in cases involving the breach of a contract. Exhibit 7-2Types of Tort Damages TYPE PURPOSE AMOUNT Compensatory To make the plaintiff whole again. An amount equivalent to all losses caused by the tort, including compensation for pain and suffering, but not attorney fees. Nominal To recognize that the defendant committed a tort against the plaintiff. A trivial amount, typically $1 to $5. Punitive To punish the defendant and deter future wrongdoers. An amount based on two factors: the severity of the wrongful conduct and the wealth of the defendant. Compensatory Damages Because the primary objective of tort law is to compensate victims,

the primary type of damages are compensatory damages, damages designed to compensate the victim for all the harm caused by the person who committed the tort, often referred to as the tortfeasor. Although we seem to hear a lot about runaway jury awards, there does not seem to be evidence of a trend toward increasingly huge jury awards. Page 164 Compensatory damages are typically awarded for pain and suffering, costs of repairing damaged property, medical expenses, and lost wages. In the case opener, Dr. Bongiovi argued on appeal that the compensatory damages were excessive, but the appellate court upheld them, noting that when one is defamed in their line of business, they are entitled to general damages for harm to their reputation. In light of the fact that after the allegations the number of exotic dancers seeking Dr. Sullivan's services declined, the amount did not seem unreasonable to the court. Surprisingly, attorney fees are not recoverable as compensatory damages, despite the fact that most plaintiffs could not bring an action against the tortfeasor without hiring an attorney. Because the plaintiffs in personal injury cases must usually pay their attorneys anywhere from one-third to one-half of their recovery, some argue that compensatory damages fail to meet the intended goal of properly compensating victims. Others point out that one of the ways plaintiffs can, in essence, recover their attorney fees is by increasing their pain and suffering damages enough to cover these expenses. Nominal Damages Nominal damages are a small amount of money given to recognize that a defendant did indeed commit a tort in a case in which no compensable damages were suffered by the plaintiff. A plaintiff may receive nominal damages by simply failing to prove actual damages. Punitive Damages Punitive damages are awarded to punish the defendant. They are given only when the defendant's conduct is extremely outrageous. The purposes of punitive damages are both to punish the defendant and to deter him and others who are similarly situated from engaging in that kind of activity again. In awarding punitive damages, juries usually consider the egregiousness or willfulness of the tort and the wealth of the defendant. Obviously, the more wrongful the nature of the defendant's act, the greater the desire to send a message that such behavior will not be tolerated; and the greater the wealth of the defendant, the higher the damages must be to actually punish the defendant. Although the threat of large punitive damages is seen by many groups, including consumer advocates, as a good method for encouraging manufacturers to produce the safest possible products, others disagree. They believe that no threat beyond compensatory damages is required; and they argue that the main effect of punitive damages is to discourage innovation because manufacturers will be afraid of the risk of producing a defective product,

which could cost them millions in punitive damages. Since the late 1970s, insurance companies and tort reform groups have been trying to limit the amount of punitive damages that can be assessed, using both the legislative process and the courts. The 1994 case of Honda Motor Company v. Oberg12 provided tort reformers with their first judicial victory. In this case, the U.S. Supreme Court finally struck down a punitive-damage award as being a violation of due process. Oberg, however, was a limited victory because of two unique aspects of the case. First, the punitive damages were over 500 times the amount of the compensatory damages, which is extraordinarily rare. Second, the state law under which the damages were awarded was the only state law in the country that had no provision for judicial review of the amount of punitive-damage awards, and it was the denial of this safeguard that violated the due process clause. Because of its unusual facts, Oberg did not provide much guidance about when punitive damages were so excessive that they violated due process. CASE Nugget The Truth behind the McDonald's Scalding Coffee Case Liebeck v. McDonald's Restaurant District Court, Bernalillo County NM 1995 WL 360309 (August 18, 1994) The case that is often seen as an illustration of excessive punitive damages is the so-called "McDonald's Hot Coffee Case," yet most people do not know the facts of the case, and if they did, they would realize that the case is really an example of how tort law can be a tool for improving consumer safety. Now you will know the real story of this famous case. Stella Liebeck was a 79-year-old woman whose grandson had taken her through the McDonald's drive through to purchase a cup of coffee. He then parked the car to allow Stella to put cream and sugar in her coffee. Because at this time there were no cupholders in cars, she placed the coffee between her legs to remove the lid. When she did so, the coffee spilled out onto her lap, and was absorbed by her cotton sweatpants and held against her skin. The 180-190-degree liquid scalded her thighs, buttocks, and groin, causing her third degree burns that resulted in her requiring skin grafts. Her medical bills were around $10,500 and future bills estimated at $2,500. Mrs. Liebeck did not wish to sue but asked McDonalds for $20,000 to cover her medical bill and the wages her daughter lost from taking time off work to transport Mrs. Liebeck to her numerous hospital visits. McDonald's offered $800, so she sued. While initially many of the jurors thought it was absurd that someone would spill coffee on themselves and then sue the provider of the coffee, they ultimately awarded her $200,000 in compensatory reduced to $160,000 based on their using comparative negligence and finding her 20% responsible for her injuries, along with $2.7 million in punitive damages. The trial court judge reduced the punitive damages to $480,000, three times the compensatory

damages. Mrs. Liebeck, however, did not collect that amount, but rather settled for a lower amount. So, why is that award reasonable? The primary reason was that McDonald's conduct was, to use the trial court judge's language, "reckless, callous and willful." They were serving their coffee at a temperature of 180–190 degrees, a temperature substantially higher than that at which other establishments were serving their coffee, and a temperature that could cause third degree burns in two to seven seconds. Had the coffee been served at 155 degrees, it would have cooled enough that Mrs. Liebeck would not have suffered third degree burns. Coffee served at home is typically a safer 135–140 degrees, and some experts claim that the ideal temperature for consumption of coffee is from 145–155 degrees. Further, McDonald's knew how dangerous it was to serve coffee at that temperature. Discovery in the case revealed that over the previous 10 years, McDonald's had received over 700 complaints from consumers burned by their coffee, reporting varying levels of burn severity, including some third-degree burns, and they had paid out around $500,000 to settle burn complaints. One of their executives even testified at the trial that they knew about the possibility of severe burns that most people wouldn't recognize were possible, but they did not warn consumers of this potential hazard, nor did they intend to change any of their hot coffee policies. It also came out during the trial that McDonald's insisted on serving their coffee at such a high temperature because it saved them money. When you serve coffee that is too hot for people to drink, it will take people much longer to finish their coffee and therefore they will be less likely to get a free refill that costs the firm money*. Today, McDonald's coffee cups have a label that says, "CAUTION HOT." Page 165 A few years later, however, in BMW v. Gore,13 the Supreme Court set forth a test that a number of commentators thought would substantially curb punitive-damage awards. The Court said three factors should be considered in determining whether an award was grossly excessive: "the degree of reprehensibility of the nondisclosure; the disparity between the harm or potential harm suffered by [the plaintiff] and his punitive damages award; and the difference between this remedy and the civil penalties authorized or imposed in comparable cases." However, a 1999 study found that the year after BMW v. Gore, punitive-damage awards across the country were not reduced any more frequently than they had been the year before the decision.14 Page 166 Since BMW v. Gore, the Supreme Court has continued to encourage the courts to scrutinize punitive-damage awards carefully. In the 2001 case of Cooper Industries, Inc. v. Leatherman Tool Group, Inc.,15 the high court ruled that appellate courts must review the trial court's decision on the constitutionality of an award de novo, meaning they

should no longer give deference to the trial court's determination that the jury award was not unconstitutionally excessive and uphold it unless there was a clear abuse of discretion on the part of the trial court judge. In the 2003 case State Farm v. Campbell,16 the Supreme Court once again addressed the issue of how to determine punitive damages properly. The Campbells had won a jury verdict for $1 million in compensatory damages and $145 million in punitive damages after State Farm failed to settle what was clearly a valid claim. The high court ruled that punitive-damage awards should bear some relationship to the actual harm caused and should not focus on the wealth of the defendants. Although refusing to draw a firm line about what ratio of compensatories to punitives was acceptable, the Court did say that "in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process."17 The Court also stated that damages should not focus on deterrence based on wealth or on actions unrelated to the case at hand. Case 7-4 demonstrates how the courts are applying these guidelines today. CASE 7-4 MAZDA MOTOR CORPORATION v. HURST Alabama State Supreme Court 2017 LEXIS 66 FACTS: In November 2010 16-year-old Sydney McLemore was driving with her 15-year-old friend Natalie in the passenger seat. Sydney was speeding and lost control of the vehicle, resulting in it spinning into a light pole. The vehicle burst into flames shortly after the collision. Sydney suffered third degree burns but escaped the vehicle. Unfortunately, Natalie did not survive the fire. In 2012, Natalie's parents filed a wrongful death suit against Mazda. The Hursts alleged that the 2008 Mazda3 that Sydney drove was not crashworthy because its fuel system was defectively designed. They argued that the fuel tank was positioned a half-inch from the steel muffler with sharp, protruding edges. The Hursts contended that this design caused the muffler to pierce the fuel tank upon collision and start the fire. At trial, the Hursts brought forth several expert witnesses. One expert, Jerry Wallingford, presented a strong case against Mazda. Based upon his decades of experience in the automotive testing industry, he testified that Mazda's fuel tank design goes against industry design safety standards that have been in place since the 1970s. The jury awarded the Hursts $6.9 million in wrongful-death and punitive damages. Mazda appealed. On appeal, Mazda argued that the fine was excessive because Mazda could not have reasonably foreseen the design causing a deadly fire. ISSUE: Could Mazda have reasonably foreseen the fire risks of its design? Should the plaintiff's $3 million punitive-damage award be struck down as constitutionally excessive when the amount of the compensatory damages is $471,258.26? REASONING: Mazda's arguments as to why the

award should be reduced based on the “guideposts” discussed in BMW of North America, Inc. v. Gore are inadequate. Those guideposts are: ‘(1) the degree of reprehensibility of the defendant’s conduct; (2) the ratio of the compensatory damages award to the punitive damages award; and (3) the difference between the punitive damages award and comparable awards in similar cases.’ With respect to second guidepost, the degree of reprehensibility of the defendant’s conduct, Mazda’s argument that because there is insufficient evidence of wanton misconduct in this case, there likewise is insufficient evidence of “reprehensibility” fails because this guidepost is also treated differently in the wrongful-death context. In these cases, the jury is authorized to award punitive damages on a negligence claim when other factors exist. In Alabama, the legislature has authorized the jury to ascertain an amount of damages appropriate to the goal sought to be achieved — preservation of life because of the enormity of the wrong, and the jury’s consideration of the ‘enormity of the wrong’ includes assessing the finality of death, the propriety of punishing the wrongdoer or wrongdoers, whether the death could have been prevented, and, if so, the lack of difficulty that would have been involved in preventing the death, as well as the public’s interest in deterring others from committing the same or similar wrongful conduct.as in this case where the plaintiffs demonstrated that it would not have been difficult to avoid the defect found by the jury to have caused the fire in question, the second guidepost is satisfied. With respect to the second guidepost, the degree of reprehensibility of the defendnt’s conduct, Mazda contends that “the punitive-to-compensatory ‘ratio’ counsels remittitur.” The ratio factor does not apply in this case because in Cherokee Electric Cooperative, this Court observed that “Alabama law allows no compensatory damages in a wrongful death case.” Finally, with respect to the third guidepost, the difference between the punitive damages award and comparable awards in similar cases, Mazda’s argument that the jury’s punitive-damages award bears no relation to any civil penalty, sanction, or jury verdict in a comparable case because there haven’t been any cases against Mazda fails because there have been comparable wrongful death cases where such awards have been upheld even when the defendant has no history of the defendant’s being the subject of other actions. Becuase the punitive damages award is not out of line with awards in other wrongful death cases, this guidepost has been satisfied. DECISION AND REMEDY: Because none of the factors Mazda raises weighs in favor of a remittitur, the court concludes that the trial court did not err in upholding the Hursts’s award of $3.9 million for the death of their daughter. SIGNIFICANCE OF THE CASE: This case provides an illustration of the application of the Gore

guideposts to determine when punitive damages may be considered excessive. CRITICAL THINKING What evidence, had it existed, do you think might have convinced the justices to overturn the judgment of the lower court? ETHICAL DECISION MAKING What values are guiding the judge's decision that the punitive-damage award was not excessive? Do you think that the values promoted by the decision are appropriate for the situation? Why or why not? Page 167 CASE OPENER WRAP-UP Plastic Surgeon Defamation On appeal, Dr. Bongiovi argued that Dr. Sullivan was a public figure and, as a result, the jury should have been instructed that actual malice had to be shown. The supreme court of Nevada held that Sullivan did not qualify as a public figure because he "did not voluntarily interject himself into a public [medical] controversy." Additionally, the court found that the awarded compensatory and punitive damages were proper. Sullivan had lost income as the result of Bongiovi's statement, and the compensatory damages were equivalent to the income lost. According to the court, the punitive-damage award was "reasonable and proportionate to the amount of harm to Sullivan" and would adequately serve as a deterrent. The district court ruling was affirmed. Page 168 PRACTICAL TIPS for Business Managers As tempting as it may be to badmouth your competitors and try to tarnish their reputation, you must be careful. Lying about your competitors in order to make them look bad can land you in court for libel or slander and cost you enormous amounts of money. When advertising your business or publishing business-related materials, be sure that the materials are either entirely original or that you have the proper permissions to use them. It can be very easy to appropriate someone's image without necessarily knowing you did so illegally. As a business manager, you need to worry not only about your customers's safety but your employees's safety as well, especially if your business involves potentially hazardous workplaces. To avoid negligence suits from injured employees, establish strict safety protocols and do daily checks to ensure that these protocols are being followed. If your business involves high-stakes endeavors (e.g., an accounting firm or a medical clinic), it may be wise to invest in professional liability insurance. That way, if something happens to go wrong, you are not at risk of losing everything from one bad lawsuit.

SUMMARY Introduction to Tort Law Tort: A civil wrong giving the injured party the right to bring a lawsuit against the wrongdoer to recover compensation for the injuries. Classification of Torts Torts are classified as intentional, negligent, and strict liability. Intentional Torts Torts against persons include

assault, battery, and defamation. Torts against property include trespass to realty, private nuisance, trespass to personal property, and conversion. Torts against economic interest include disparagement, intentional interference with contract, unfair competition, misappropriation, and fraudulent misrepresentation. Negligence The plaintiff must prove four elements: duty, breach of duty, causation (actual and proximate), and damages. Plaintiff's Doctrines Doctrines used to establish negligence: Res ipsa loquitur Negligence per se Defenses to Negligence Contributory negligence Modified comparative negligence Pure comparative negligence Assumption of the risk Strict Liability Persons who engage in activities that are so inherently dangerous that no amount of due care can make them safe are strictly liable, regardless of the degree of care they used when undertaking the activity. Damages Available in Tort Cases Compensatory damages to make the plaintiff whole again. Punitive damages to punish the defendant and deter future wrongdoers. Nominal damages to recognize that the defendant committed a tort against the plaintiff.

Point/Counterpoint Should Punitive Damages Be Abolished? YES NO Punitive damages are an unnecessary aspect of tort law that do more harm than good. The justice system, especially tort law, are about making the injured whole. Compensatory damages fulfill this purpose by delivering a needed and deserved remedy to an injured party. By definition, punitive damages go beyond recompensing an injured party and can often serve as a windfall. If the justice system is concerned with fairness, then why should it reward litigants with compensation beyond what they are duly owed? Eliminating punitive damages in the name of fairness would also have a positive effect on juries. Juries in any tort case already have a lot of facts and issues to consider. Asking them to consider punitive damages can distract them from focusing on the important aspects of a tort case, that is whether the defendant harmed the plaintiff through a breach of a duty. Finally, taking punitive damages out of the equation would lower the stakes of a number of cases, which would have several effects. For one, limiting damages to the amount that would make the plaintiff whole would make it easier for defendants to pay judgments. Even if a plaintiff wins a case, he or she may not actually get the relief they need if excessive punitive damages make payment impossible for the defendant. Lowering the stakes also makes alternate dispute resolution more attractive, and both parties may be able to reach a more mutually amenable (and less expensive) result through mediation or arbitration. Additionally, doing away with punitive damages

would limit attorney fees on tort cases, which encourages lawyers to pursue a case for its merits rather than its profit potential. Often, when an individual or entity harms someone, the harm can be made up for with just compensation. But sometimes, someone does something so egregious and with such disregard for social norms that they harm not only a particular person, but society as a whole. Punitive damages are needed when harm done goes beyond compensable damages and when we need to show other potential violators that certain behavior is not acceptable in our society. Punitive damages may be harsh, but that is the point: punitive damages need to be expensive enough that they are truly a punishment that deters unacceptable behavior. We live in a time where many entities decide that litigation costs are cheaper than the cost of compliance with rules and regulations. Thus, corporations will flaunt the rules and harm numerous people in the process simply to save money. When compensatory damages are not enough to prevent bad behavior, punitive damages are one of the only tools we have to ensure (or at least strongly encourage) social responsibility. Finally, punitive damages need not be the windfall they are often criticized for being. Many states have laws that require at least a significant portion of a punitive damage award to go somewhere other than to the plaintiff, often to a fund to help victims of a similar tort or another public interest use. Punitive damages can thus turn a condemnable act by a defendant into something positive for society.

Questions & Problems Page 170 Distinguish the three types of damages available in tort cases. Explain why some people see punitive damages as a necessary aspect of our tort system, whereas others want to restrict their availability. List five intentional torts and explain the elements needed to prove each. List and define the elements that are necessary to prove a case of negligence. Explain the differences between contributory and comparative negligence. Explain the relationship between negligence per se and res ipsa loquitur. Sabrina Ederly worked as a reporter and contributing editor for Rolling Stone magazine. Ederly intended to write an article for the magazine that focused on the alleged rape of a University of Virginia Student (UVA) referred to as “Jackie.” Following Jackie’s assault, Jackie was put in touch with Nicole Eramo, the associate dean of students at UVA. Throughout Ederly’s investigation, she interviewed Jackie about the incident and her interactions with Eramo. Ederly also interviewed a number of students about sexual assault at UVA; several students expressed their admiration of Eramo during these interviews. Ederly did not, however, interview any of the alleged

perpetrators or Eramo herself. Similarly, Ederly did not corroborate Jackie's story with documents Jackie claimed to have access to. Ederly relied almost entirely on Jackie's account of the incident. The article Ederly would go on to publish castigated Eramo for her alleged indifference and inaction towards Jackie's case. Soon after the article's publication, investigations led by independent entities found that the article and key components of Jackie's story could not be substantiated. Ederly was criticized for her lack of diligence in corroborating the story or reaching out to anyone besides Jackie and some unrelated students. Rolling Stone eventually retracted the story, but the damage to Eramo was already done. Her reputation as an advocate and supporter of victims of sexual assault was ruined, and she received hundreds of threats from the public. Eramo sued Rolling Stone for defamation. Rolling Stone moved to dismiss, arguing that Eramo is a public figure and the article was published without actual malice. How do you think the court ruled? Source: Eramo v. Rolling Stone, 209 F. Supp. 3d 862 (W.D. Va. 2016). In the months leading up to the 2016 election, Christopher Steele, a former British intelligence agent, was hired by a Washington, D.C., research firm to investigate whether then-candidate Donald Trump had any ties to Russia and Vladimir Putin. While Steele's report was relatively inconclusive on Trump, it did report on the dealings of three Russian businessmen: German Khan, Mikhal Fridman, and Petr Aven. Steele's report alleged that the businessmen advise Putin on foreign policy, especially concerning the U.S., and that they used their connections to "deliver large amounts of illicit cash to the Russian president [Putin]" in the 1990s. The trio sued Steele's firm for defamation and Steele moved to dismiss, arguing his words are protected by First Amendment. Is Steele's report protected by the First Amendment, despite Steele not being an American citizen? How do you think the court ruled on the First Amendment and defamation issues? Source: Khan v, Orbis Business Intelligence Limited, Case No. 2018 CA 002667 B (D.C. Superior Court) The NFL hired the law firm of Paul, Weiss, Rifkind, Wharton & Garrison LLP and one of its partners, Theodore Wells to investigate allegations of bullying within the Dolphins organization. After receiving the firm's report, the Dolphins fired then offensive line coach James Turner. The investigation had centered on the bullying of a football player, Jonathan Martin, who had abruptly left the Dolphins team midway through the 2013 season. After several months of investigation, Paul, Weiss published a 144-page report that concluded that bullying by other Dolphins players contributed to Martin's decision to leave the team. The Report also included several references to Coach Turner and opined that Coach Turner's unprofessional conduct, including discouraging players from "snitching" on

one another, played a role in Martin’s struggles. After his termination, Turner sued Wells and the law firm that conducted the investigation for defamation. Defendants filed a motion to dismiss on grounds that (1) the report consisted of opinions and therefor was not actionable in a defamations case; (2) the complaint failed to identify any false statements of fact in the report; and (3) plaintiff was a public figure and failed to plead actual malice in the complaint. The trial court granted the Defendants’ motion to dismiss and plaintiff appealed. How do you think this case handled by the appellate court and why? Why do you believe Turner was or was not a public figure? Source: Turner v. Theodore V. Wells, Jr., Paul, Weiss, Rifkind, Wharton & Garrison, LLP, Case No. 16-15692 (11th Cir. Court of Appeals, 2018), available at https://cases.justia.com/federal/appellate-courts/ca11/16-15692/16-15692-2018-01-18.pdf?ts=1516303835. Floyd Mayweather, Jr., and Shantel Jackson were a highly publicized couple for a number of years before their relationship frayed and eventually ended in discord. In early April 2013, Jackson decided to end her relationship with Mayweather. However, Mayweather convinced Jackson to return to his home in Las Vegas. After a few days, the couple resumed fighting and Jackson attempted to leave. Jackson alleged that Mayweather declared he would not let her leave. According to her, Mayweather would only let her leave the Las Vegas abode under the supervision of one of his employees. Jackson eventually moved back to Los Angeles in June 2013. In November 2013, she became pregnant by Mayweather. A December 2013 sonogram revealed twins. A month later, she terminated the pregnancy. In April 2014, Mayweather demanded Jackson take down photographs she had posted on social media that featured her and a rapper at a basketball game. After she refused, Mayweather made posts on his Facebook and Instagram accounts, “the real reason me and Shantel Christine Jackson @MissJackson broke up was because she got an abortion, and I’m totally against killing babies. She killed our twin babies. #ShantelJackson #FloydMayweather #TheMoneyTeam #TMT.” In addition to the post, Mayweather posted pictures of the sonogram and a medical report regarding the pregnancy. In September 2014, Jackson filed suit against Mayweather for, among other claims, invasion of privacy through the public disclosure of private facts and false light. Do you believe she has a basis for either of these claims? Source: Jackson v. Mayweather, 10 Cal. App. 5th 1240 (2017). Page 171 In May 2009, Bryan Lyles was admitted to the LSU Health Sciences Center and underwent an anterior corpectomy and discectomy surgery. During the procedure, Lyles’s C5 vertebrae was replaced with a Verte-Stack implant. Additionally, an Atlantis Plate was inserted to hold the Verte-Stack in place and promote its union with the C4 and C6 vertebrae.

Lyles was discharged the day after the operation after having several x-ray images taken. About a week later, Lyles returned to the hospital, complaining that the condition he had undergone the surgery for had not abated. Additional images of Lyles's spine were taken, and the doctor who conducted the surgery found slight displacement of the Atlantis Plate but no breakage. Lyles symptoms showed no improvement, and he eventually underwent another surgery. Regardless of the surgery's results, Lyles sued MSD, the company that designed and created the Atlantis Plate, for defective design and defect claims under the assertion that the Atlantis Plate had broken. To support his claim, medical experts hired by Lyles alleged that the images taken shortly after the first surgery and after Lyles returned the first time showed that the Atlantis Plate had come apart. The surgical doctor maintained that at no time did the Atlantis Plate break. Lyles made his liability claim under the theory of res ipsa loquitur. What kind of evidence would Lyles have to present to satisfy this theory? Do you think Lyles's expert's opinions are sufficient for him to win the case? How did the court rule? Source: Lyles v. Medtronic Sofamor Danek, USA, Inc., 871 F. 3d 305 (2017). Rockstar Games, a subsidiary of Take-Two Interactive, released the video game Grand Theft Auto V in 2013. The game features a character named Lacey Jonas, a self-proclaimed "actress slash singer" and "voice of a generation," who appears in both in-game scenes and promotional artwork for the game. Actress Lindsay Lohan alleged that the fictional character is her "look-a-like" and misappropriates her portrait and voice in violation of New York privacy law. Being that Lohan did not give her consent for the alleged use of her portrait and voice, she sued Take-Two for compensatory and punitive damages. In response, Take-Two moved to dismiss on the grounds that the character is not based on Lohan and that creative works like video games cannot give rise to privacy claims. Is Take-Two correct that one's alleged depiction in a video game cannot be the basis for a privacy claim? Why or why not? Source: Lohan v Take-Two Interactive Software, Inc., 92 N.E.3d 807 (N.Y. 2018). Defendant McPherson owned property adjacent to the first Presbyterian Church and wanted to build a gas station on the property. The church sued, arguing that the operation of the station would constitute a nuisance. The lower court found that the unusual noises emanating from the station would interfere with the church's operation to such an extent that it would be a nuisance and therefore granted the permanent injunction. On appeal, do you believe the injunction was upheld? Why or why not? Source: McPherson v. First Presbyterian Church of Woodward et al., 120 Okla. 40; 248 P. 561 (2015). Plaintiff withdrew $4,000 in cash from his T.D. Bank account on August 28, 2014, and proceeded to

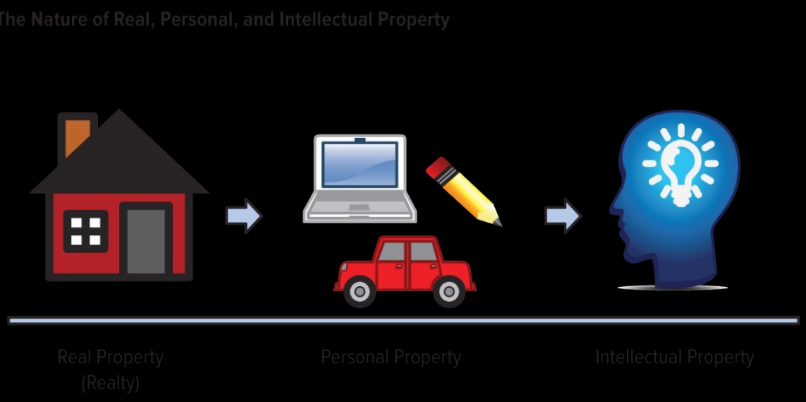
dinner at Prime restaurant. He left 36 one hundred-dollar bills in the center console of his car and gave exclusive custody and control of his vehicle to employees of the defendant restaurant valet service, Advanced Parking Services. The plaintiff retrieved his vehicle one hour and 40 minutes later, only to discover that $3,600 in cash was missing. The plaintiff filed a small claims action to recover said sum, asserting a number of causes of action, including negligence. Regarding the negligence claim, defendants produced no witnesses or evidence, but claimed to have no knowledge concerning the matter. Plaintiffs argue that, using the doctrine of res ipsa loquitur, the happening of the loss permits, but does not compel, the court to draw an inference that the defendants were negligent. They claimed: the instrumentality that caused the accident was in the exclusive control of the defendant; the event does not ordinarily occur in the absence of someone's negligence; and the event was not due to any voluntary action or contribution on the part of the plaintiff. Plaintiff's sworn testimony and exhibits excluded the possibility that the plaintiff himself caused or contributed to the loss, as he was in the restaurant at the time the money disappeared. How do you believe the course resolved this dispute? Why? Source: Zinner v. Advanced Parking Servs. (2015). https://law.justia.com/cases/new-york/other-courts/2015/2015-ny-slip-op-25246.html.

Part 1 The Legal Environment of Business CHAPTER 8 Real, Personal, and Intellectual Property Page 172 CASE OPENER Smartphone Wars: Focus on Technology Companies In the past five years, there have been significant innovations in technology such as smartphones and tablets. Technology companies rely on intellectual property law (IP), such as patents, trademarks, copyright, and trade secrets, to protect their innovations. For example, Apple and Samsung, the two largest smartphone companies, have filed various patent infringement suits against each other in courts around the world. Apple and Samsung are strong competitors, so if one company were able to obtain an injunction preventing the other company from selling certain phones and tablets, this injunction could be devastating to the losing company. In one of these cases that proceeded to a jury trial, Apple argued that Samsung copied Apple's design of the iPhone and iPad—specifically, that Samsung copied the rounded rectangle shape of the iPhone, in violation of Apple's design patent and the iPhone's trade dress. Steve Jobs, the former CEO of Apple, emphasized the importance of neat, clean design for Apple products, and Apple has thus sought and received hundreds of design

patents, along with trademarks, protecting its products. Similarly, Samsung has asserted a number of its own patents against Apple, including a patent covering the ability to send photos from a camera phone. Critics argue that these patents and trademarks are too broad (i.e., that something as simple as a rounded rectangle or sending a photo from a phone should not be protected by patents or trademarks). Critics further argue that such broad IP stifles innovation and prevents smaller players from entering the market because they cannot withstand the costs of litigation associated with competing in the smartphone and tablet markets. In response, the patent owners argue that they have expended significant resources in creating their products and deserve to avail themselves of the protection afforded by IP. Critics further argue that technology companies spend millions of dollars on litigation rather than on developing and improving products. Technology companies respond that they have no choice but to seek enforcement of their intellectual property through the legal system. Furthermore, in January 2013, Apple Computer was granted a trademark for its retail store design and layout.1 Specifically, the trademark covers the design, the shelves in the store, and the location of the tables displaying products. One of the main reasons this trademark was important to Apple was that fake Apple stores in China confuse customers. Do you think technology companies should be able to receive protection for allegedly basic ideas (e.g., store design or shape or color of a product) and functionalities? How does intellectual property litigation between competitors (such as Apple and Samsung) affect you? Page 173 LEARNING OBJECTIVES LO 8-1 Explain how the topics of real, personal, and intellectual property are related. LO 8-2 Describe how real property law balances private and public rights. LO 8-3 Outline the interests in real property that someone can hold. LO 8-4 Identify the types of personal property. LO 8-5 Describe how personal property is transferred. LO 8-6 Describe how intellectual property law balances private and public rights. LO 8-7 Differentiate among the methods for protecting various types of intellectual property. Most Americans cherish the right to own property. For most Americans, this means the right to own real property, such as a house. Increasingly, Americans also cherish the right to own intellectual property, the fruits of the mind, such as a manuscript for a novel. In this chapter, we examine the nature of both real and intellectual property, as well as personal property. The chapter starts by exploring how the three areas of law are related. Then, for each of these types of property, the chapter considers what interests individuals can hold and how the laws governing these types of property balance private and public rights. The Case Opener considers an intellectual property issue. By the end of the chapter, you will see that

disputes such as the Samsung–Apple dispute can arise not only when the property in question is intellectual but also when it is personal property.

The Nature of Real, Personal, and Intellectual Property LO 8-1 Explain how the topics of real, personal, and intellectual property are related. The type of ownership interest a person has in a piece of property determines his or her rights to the property. Real property, commonly referred to as realty, is land and everything permanently attached to it. Personal property consists of tangible, movable objects. Intellectual property consists of the fruits of one's mind. The laws of intellectual property protect property that is primarily the result of mental creativity rather than physical effort. When we are thinking about property rights of any kind, it is important to remember that society, through laws, decides what rights individuals and communities have with regard to property. Exhibit 8-1The Nature of Real, Personal, and Intellectual Property One metaphor often used with regard to property is that of a bundle of sticks. Each stick represents a distinct right an individual can have with regard to property. The rights to possess property, use it, give it away, or take it away are all sticks. With regard to all types of property, one of the most important rights is the right to exclude others. For example, with regard to real property, an individual can put a fence around the land and ask others to stay off the land. With personal property, you may simply keep it in a place where no one else has access to it. For intellectual property, an individual can accomplish the same thing with a trademark or patent—the holder can put a virtual fence around the idea trademarked or patented and ask others to refrain from using the property. Page 174 With regard to real property, some other important sticks are the rights to sell, lease, or mortgage land and the right to allow someone limited access. The public also has important sticks, such as the right to take land, regulate it, and/or tax it. In the next section, the various types of interests a person may have in real property are described in detail. These interests may be conveyed or transferred under legal guidelines for property rights. Most transfers of property are voluntary. However, for the benefit of the public, and to protect public health, safety, and welfare, the government may require involuntary transfers of property.



Real Property LO 8-2 Describe how real property law balances private and public rights. There are a number of types of interests in land, ranging from temporary to permanent to future. The duration of one's ownership interest and the power one has over using the land depend on the type of estate one is said to hold. The following section on interests in real property describes the various estates in detail. First, though, this chapter explores the landowner's rights that pertain to areas beyond the surface of the land itself. Extent of Ownership When a person owns land, they own more than just the surface. The airspace above the land, extending to the atmosphere, is also part of the legal concept of real property. Rights to airspace generally do not generate much controversy, but occasionally disputes arise that involve aircraft flying too low over individuals' property. Alternatively, a tree's branches may hang over into the airspace of the property next door, and the owner of that airspace may want to cut the overhanging branches. In dense, commercial urban areas, airspace may actually be an asset. Owners of two commercial buildings might want to build an overhead walkway joining their buildings across a parking lot that you own. They will have to pay you handsomely for the right to build in your airspace. In addition to having airspace rights, the owner of real property also has water rights, the legal ability to use water flowing across or underneath the property. However, these rights are somewhat restricted; one cannot deprive the landowners downstream from the use of the water by diverting the water elsewhere. Finally, ownership of real property extends to mineral rights; these rights involve the land below the surface. The landowner has the legal ability to dig or mine the materials from the earth and may sell or give these rights to another person. Ownership of these subsurface rights includes the right to enter onto the property to remove the underground materials. All these

additional rights are illustrated in Exhibit 8-2. Page 175 Exhibit 8-2Extent of Rights Interests in Real Property LO 8-3 Outline the interests in real property that someone can hold. Various interests in land are discussed in the following sections and summarized in Exhibit 8-3. Exhibit 8-3Possessory Estates in Land INTEREST EXTENT OF RIGHTS Leasehold estate Right to possess property for an agreed-on period of time Life estate Right to possess property until death, subject to restriction against waste Conditional estate Right to possess property by which the holder has the same interest as that in a fee simple absolute except that this interest is subject to a condition. Fee simple absolute Right to possess property for life and pass it to heirs on death; the most encompassing interest Fee Simple Absolute With regard to estates in land, a fee simple absolute is the most complete estate a person may have. Exclusive rights to ownership and possession of the land belong to the person who has a fee simple absolute. It is this type of estate to which most people refer when they speak of buying a house or piece of land. A fee-simple-absolute interest is passed to the owner's heirs when the owner of such an estate dies. Conditional Estate The owner of a conditional estate possesses the same interest as the owner of a fee simple absolute except that this interest is subject to a condition: If a certain required event fails to occur or a specific prohibited event occurs, the interest will be terminated. For example, Todd may be given property rights to a Victorian house on the condition that he is to preserve it in its original form. If he violates this condition by turning the house into a piano showroom or a beer hall, the house will either revert to the original owner or be transferred in accordance with the terms of the deed. (The deed is the instrument used to convey real property.) Life Estate A life estate is granted for the lifetime of an individual; the right to possess the property terminates at the individual's death. On the death of the holder of the life estate, the property will go to another party as designated by the original grantor. Thus, this future owner has an interest in seeing that the life tenant does not waste the property; in other words, the life holder is not allowed to neglect or abuse the property in a way that diminishes the property value. If the life tenant fails to make necessary repairs or uses the property in ways damaging to its future value, the future holder could bring legal action against the holder of the life estate to recover damages for waste. Page 176 Future Interest A future interest is a person's present right to property ownership and possession in the future. Such an interest usually exists in conjunction with a life estate or a conditional estate. For example, Joe owns a life estate in Oak Hills Apartments, and on his death the property will pass to Sarah with fee-simple-absolute rights. Sarah, in this case, holds a future interest in Oak Hills Apartments, and if Joe allows the

buildings to deteriorate from neglect, Sarah may sue Joe to enjoin him from engaging in waste of the property. Leasehold Estate The interest of a leasehold differs from the interests previously described in that the holder of such an estate has a possessory interest but not an ownership interest. This interest is transferred by a contract known as a lease. Both the owner of the property (the lessor, or landlord) and the tenant (the lessee) sign the lease. The contract generally specifies the property to be leased, the amount of the rent payments and when they are due, the duration of the leasehold, and any special rights or duties of either party. A leasehold gives the lessee, or tenant, exclusive rights to the use and possession of the land, including the right to exclude the property owner under most circumstances, for the term specified by the lease. The tenant's and landlord's rights and obligations may vary according to the lease, but some states have statutes requiring landlords to keep the property in good condition for the tenant's use and giving the tenant the right to withhold rent payments if the landlord fails to maintain the premises. However, if the tenant fails to make the agreed-on payments without such grounds, the landlord may evict the tenant. The landlord is not allowed to enter the property except when there is an emergency or when the tenant has given permission to enter to make repairs. Near the end of the leasehold, the landlord may enter with notice to the tenant for the purpose of showing the property to a potential tenant. GLOBAL Context Digital Archive Japan/Alamy Stock Photo Property Interests in Vietnam In the United States, we take for granted the right to go out and purchase a piece of property if we have the money to do so. Property is not so freely available and transferable in all nations. Vietnam's new constitution, written in 1992, provides guidelines for the allocation, transfer, and sale of private property. However, the constitution still asserts that the people, or the state, own all the land. Thus, if individuals or private enterprises want to use land, they must pay tax on it as a form of rent. Those who agree to pay the tax on the land are granted a use of right, which entitles them to extended use. The use of right also gives the renter the freedom to transfer the property. Technically, it is not the property that is being transferred but, rather, the right to use the property. Transference of property can occur only with the approval of a state official. The official ensures that the new owner intends to use the land for the original, state-approved purpose. Moreover, the new owner can never be given a longer term of right or more extensive rights over the land than the original owner had. Finally, the state official determines the price at which the property will be transferred. The government has specified certain prices depending on how the land is used. Considering the involvement of the state in such

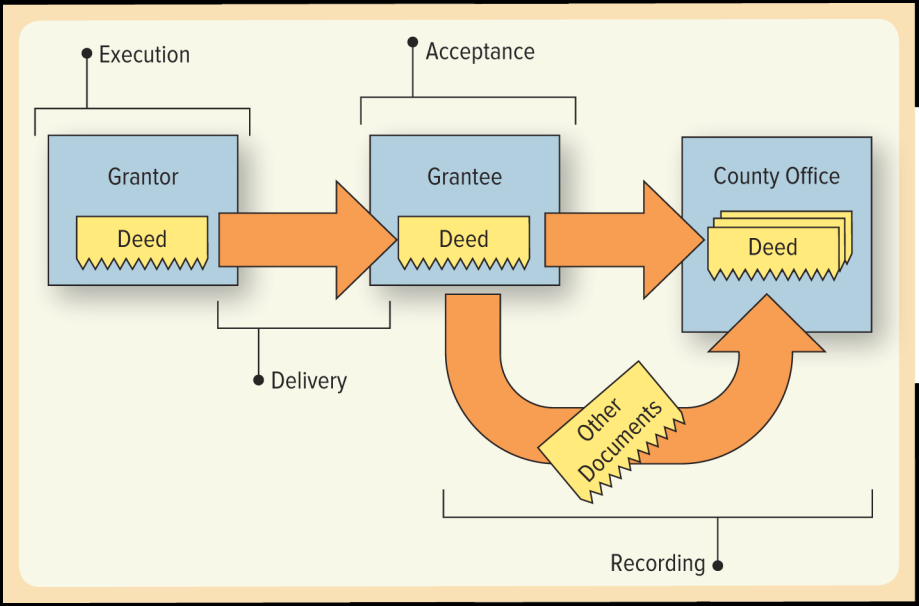
property transactions, the extent to which the Vietnamese enjoy private property rights is limited. Subleasing of the property by the tenant to another party is permissible unless specifically prohibited by the lease. However, the initial tenant is liable throughout the entire term of the lease for payment of the rent to the landlord. Page 177 Nonpossessory Estates Although most people think of interests in land as being possessory in nature, some estates do not include the right to possess the property. Such interests include easements, profits, and licenses. Easements and profits are similar in that they are neither ownership nor possessory interests, and they are subject to similar rules, but they are not exactly the same. An easement is an irrevocable right to use some part of another's land for a specific purpose without taking anything from it. A profit is the right to go onto someone's land and take part of the land or a product of it away from the land. For example, if Bill has the right to drive his car across Jenny's property to get to his property, he has an easement; but if he has the right to go onto her property and remove the topsoil he needs from it for his landscaping business, he has a profit. Easements and profits can be transferred in multiple ways: by express agreement, inheritance, necessity, implication, or prescription. If the land that benefits from the easement or profit is sold, the nonpossessory interest goes with the property. Thus, if Bill sold his land to Sonny, Sonny would also receive the easement across Jenny's property. Similarly, if Jenny sold her property, the new owner would have the burden of Bill's easement as long as it had been properly recorded. Of course, just as easements and profits can be created, they can also be terminated, with the most common method of termination being by agreement. The easement holder may simply deed the easement back to the property owner. If the easement arose by necessity and the necessity no longer exists, the easement would terminate. A license is a right to use another's property that is both temporary and revocable. For example, when a person purchases a theater ticket, he or she has the right to a specific use of the property for a limited time, subject to good behavior. No property interest goes to the license holder. Property Transfer The owner's ability to transfer real property is part of the value of property. Any or all of the owner's property may generally be transferred to anyone for any price or no price, as the owner desires. However, to effectuate such a transfer, the owner must follow certain legal procedures. These procedures are execution, delivery, acceptance, and recording (see Exhibit 8-4), the last of which is required to protect the recipient of the property. Such a transfer is presumed to be the conveyance of a fee simple absolute unless the contrary is stated. The legal document used to voluntarily convey the property is called the deed. There

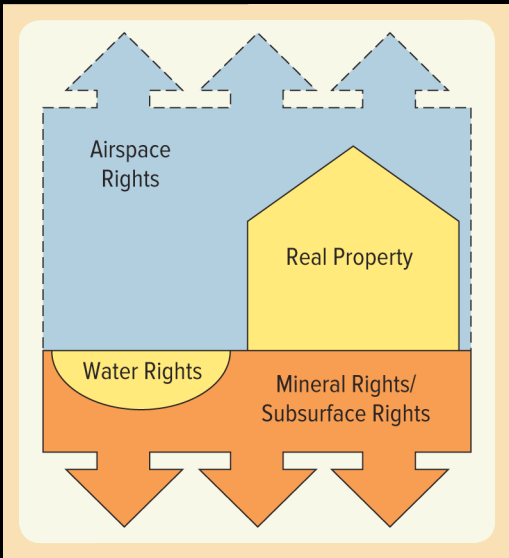
are different types of deeds, but any properly drafted deed must contain the following: Identification of the grantor, the person conveying the property, and the grantee, the person receiving the property. An expression of the grantor’s intent to convey the property. A legally sufficient description of the property, including its physical boundaries and any easements. Any warranties or promises made by the grantor in conjunction with the conveyance. Page 178 The most commonly used deed, the general warranty deed, contains certain warranties or promises by the grantor. Such covenants may vary slightly by state but generally promise that The grantor owns the interest being conveyed. The grantor has the right to convey the property. There are no mortgages or liens against the property unless stated in the deed. The grantee will not be disturbed by anyone who has a better claim to title of the property, and the grantor will defend the grantee’s title against such claims or reimburse any money spent in their defense and/or settlement. The grantor will provide any additional documents the grantee needs to perfect their title to the property. A grantor may not necessarily feel comfortable making all those warranties and may instead execute a special warranty deed, which provides only two warranties—that the grantor does hold title to the property, and that the property was not encumbered during the grantor's period of ownership. A third type of deed is the bargain and sale deed, which only guarantees that the holder has title to the property. From the grantee’s perspective, the least desirable type of deed is the quitclaim deed. It carries no warranties; the grantor simply conveys whatever interests he or she holds. Thus, if the grantor had a defective title, the grantee receives a defective title. Because of the insecurity of such a deed, very few grantees accept it. Exhibit 8-4Steps in a Voluntary Transfer The transfer of the owner’s interest in real property is not always voluntary. Transfer of property may also take place without the owner’s knowledge and even, in some cases, against his or her will by either adverse possession or condemnation. In adverse possession, a person takes ownership of property by treating a piece of real property as their own, without protest or permission from the owner. Most states have established statutes determining a length of time after which such a possessor receives the ownership interest in the property. The exact lengths of time vary from state to state, but adverse possession must be actual (the person lives on or uses the land as an owner would), open (not secretive), and notorious (without the owner’s permission). In some states, the adverse possessor must have performed certain acts such as the payment of real estate taxes. In other states, such possession must have taken place under color of title; in other words, the adverse possessor was operating under the assumption that he or

she actually held the title to the land. Condemnation is the legal process by which a transfer of property is made against the protest of the property owner. As you will remember from Chapter 5’s discussion of the takings clause of the Fifth Amendment, the government has a constitutional right to take private property for the use of the public provided it pays the owner fair compensation. This right may be exercised at any government level, and sometimes it is exercised on behalf of a private company operating to benefit the public. When the government decides to exercise its power of eminent domain, it will first make an offer to purchase the property for what it believes is the fair market value. If the owner either does not want to sell or feels the price is too low, the government will initiate a condemnation proceeding, and the court will determine whether the government body bringing the action has a valid claim that the taking is for a legitimate public purpose. If the court determines that, in fact, the taking of the property will benefit the public interest, the court will then determine the fair market value of the property. This price will be paid to the owner, and the property will be transferred to the government. It is sometimes difficult to determine whether the exercise of eminent domain is actually for the public’s benefit when the property will be conveyed by the government to another private individual. Since the 1980s, businesses increasingly have been appealing to cities to use their power of eminent domain to assist the businesses in acquiring land that the owners have not wanted to sell. Because this transference of property from one private individual to another is for the alleged public use of economic development, an increasing number of state supreme courts began to address the issue of whether economic development was a public use under the constraints of the Fifth Amendment. Some state supreme courts found that job creation and expansion of the tax base did constitute public use, whereas other courts found that they did not constitute public use. The U.S. Supreme Court finally settled the issue—at least for the present time—in the 5-4 decision summarized in Case 8-1. Page 179 CASE 8-1 KELO v. CITY OF NEW LONDON United States Supreme Court 126 S. Ct. 326 (2005) FACTS: New London, a city in Connecticut, used its eminent domain authority to seize private property to sell to private developers. The city said developing the land would create jobs and increase tax revenues. Susette Kelo and others whose property was seized sued New London in state court. The property owners argued that the city violated the Fifth Amendment’s takings clause, which guarantees that the government will not take private property for public use without just compensation. Specifically, the property owners argued that taking private property to sell to private developers was not public use. The Connecticut Supreme Court

ruled for New London. ISSUE: Does a city violate the Fifth Amendment's takings clause if the city takes private property and sells it for private development, with the hopes the development will help the city's bad economy? REASONING: The city's taking of private property to sell for private development qualified as a public use within the meaning of the takings clause. The city was not taking the land simply to benefit a certain group of private individuals but was following an economic development plan. Such justifications should be given deference. The takings here qualified as public use even though the public would not use the land. The Fifth Amendment did not require literal public use, the majority said, but the "broader and more natural interpretation of public use as 'public purpose.'" O'Connor's dissent: An unelected (therefore voter-unaccountable) private nonprofit corporation was the primary beneficiary of the government taking. "Any property may now be taken for the benefit of another private party, but the fallout from this decision will not be random. The beneficiaries are likely to be those citizens with disproportionate influence and power in the political process, including large corporations and development firms." The decision eliminates "any distinction between private and public use of property—and thereby effectively delete[s] the words 'for public use' from the Takings Clause of the Fifth Amendment." DECISION AND REMEDY: The city has not violated the Fifth Amendment. Affirmed, for New London. SIGNIFICANCE OF THE CASE: The U.S. Supreme Court expanded significantly what constitutes public use. Many people believe the Supreme Court went too far—they agree with Justice O'Connor's opinion. CRITICAL THINKING When you examine the reasoning in both the majority and dissenting opinions, you can see that a significant conflict between the opinions exists because of the ambiguity of a key term. Identify this term and explain how its interpretation affects the reasoning. How do you think the courts should define the term? ETHICAL DECISION MAKING Who are the primary stakeholders involved in this case? How are they affected by the ruling? What are the implications of this ruling in terms of the distinction between public and private property? Further, this case highlights an important value conflict. Can you explain how certain values would lead one to support the majority opinion, whereas different values would lead one to support the dissenting opinion? How might holding a different value determine how one predicts the implications of this ruling? Page 180 GLOBAL Context Digital Archive Japan/Alamy Stock Photo Eminent Domain in Germany Germany has both federal and state (Lander) regulations governing eminent domain. The federal system is similar to that in the United States, but one difference is that most of its eminent domain laws are incorporated through statutes, not through cases as in the United States. The

German federal government may expropriate land for the public good as long as it provides compensation. Germany's basic law provides that "Such compensation shall be determined by establishing an equitable balance between the public interest and the interests of those affected." Compensation in the German system is not based on fair market value alone but must also consider the interests of those affected. Germans may dispute the amount of compensation in the ordinary courts. A taking requires the government to have the legal authority for the taking. The taking must also be appropriate for accomplishing the government's purpose and must be done in the least intrusive way possible, meaning that the government cannot take property before it needs it, and it can take only the property it needs. The taking must also pass a balancing test, showing that the public's interest is greater than the owner's interest. One other difference in Germany is that if the German government no longer needs the property, it must revert to its former owner. In the United States, once the government has provided just compensation for the property, it belongs to the government. Whereas the Kelo case involves government attempts to take property from individuals to sell to companies, sometimes governments seek to take the property of one company for use by another company. For instance, in June 2000, Costco, a large retail chain, wanted to expand its warehouse in Lancaster, California. Afraid of losing the large store, which threatened to move if it could not expand, the city considered using its eminent domain powers to acquire an adjacent 99 Cents Only store so that Costco could obtain the property. This example demonstrates that even businesses may be at risk of losing their property to larger, more powerful businesses. The response to the Kelo decision was widespread. President George W. Bush issued an executive order limiting the taking of private property by the federal government to "situations in which the taking is for public use, with just compensation, and for the purpose of benefiting the general public, and not merely for the purpose of advancing the economic interest of private parties to be given ownership or use of the property taken." During the year and a half after Kelo, 30 state legislatures enacted statutes limiting the use of eminent domain. Additionally, in 2006, nine states passed ballot measures restricting the definition of public use for purposes of eminent domain. Thus, it appears that the ultimate impact of the Kelo decision will be the opposite of what that decision held; by statute, a much more restrictive definition of public use will govern government takings. The case is also important because it shows how constitutional issues directly affect areas of the law, such as property law.





Personal Property LO 8-4 Identify the types of personal property. All property that is not land or not permanently affixed to land is personal property. Personal property may be either tangible or intangible. Tangible property is property that can be identified by the senses. It is property that you can see or touch. Tangible property includes items such as furniture, cars, and other goods. Page 181 Books are typically thought of as personal property. The owner of a book may write in it and generally do what he or she wants with it, and the law protects the owner against having the book taken by someone else. However, the growing popularity of e-books has raised questions about

what rights e-book users have to their e-books. In July 2009, Amazon deleted copies of George Orwell’s 1984 and Animal Farm directly off people’s Kindles (Amazon’s e-book reader) and refunded their money. This action has sparked massive controversy over whether Amazon has the right to remove content that customers had bought from their Kindles. At least one lawsuit has already been filed as a result of this incident. Much of the outrage has been because people do not see e-books and physical books as different types of property. Businesses that offer digital content should be clear about what rights customers have to the content, and they should make that information well known and visible to avoid problems like the one Amazon is faced. Intangible property includes such items as bank accounts, stocks, and insurance policies. Because most intangibles (with the exception of some that are classified as intellectual property and discussed later in this chapter) are evidenced by writings, most of the following discussion applies to both tangible and intangible property. The primary issues that arise in conjunction with personal property involve the means of acquiring ownership of the property, which is discussed in the next section. Voluntary Transfer of Property LO 8-5 Describe how personal property is transferred. Voluntary transfer, as a result of either a purchase or a gift, is the most common means by which property is acquired. Ownership of property is referred to as title, and title to property passes when the parties so intend. When transfer of the property is by purchase, the acquiring party gives some consideration to the seller in exchange for title to the property. Such a transfer of ownership usually requires no formalities, but in a few cases, changes of ownership must be registered with a government agency. Sales of motor vehicles, watercraft, and airplanes are among the primary transfers requiring registration. To transfer such property, a certificate of title must be signed by the seller, taken to the appropriate government agency, and then reissued in the name of the new owner. Gifts are another voluntary means of transferring ownership. They differ from purchases in that a promise to make a gift is unenforceable. Once properly made, however, a gift is irrevocable. Three elements are necessary for a valid gift. First, there must be a delivery of the gift. Delivery may be actual, which is the physical presentation of the gift itself, or constructive, which entails the delivery of an item that gives access to the gift or represents it, such as handing over the keys to a car. Second, the delivery must be made with donative intent to make an immediate gift. The donor makes the delivery with the purpose of turning over ownership at the time of delivery. Third, there must be acceptance, a willingness of the donee to take the gift from the donor. Usually, acceptance is not a problem, although a donee may not want to accept a gift because of

a desire not to feel obligated to the donor or because of a concern that ownership of the gift may impose some unwanted legal liability. Sometimes, however, it can be difficult to determine whether something is a gift or a loan, especially when proper documentation is not filed at the time of the transaction. This was the scenario faced by Don Whittington when he disputed ownership of a 1979 Kremer Porsche displayed at the Indianapolis Motor Speedway Hall of Fame Museum. Whittington believed that he was the owner of the Porsche and that he had merely loaned it to the museum in 1980. The Indianapolis Motor Speedway Foundation believed that Whittington had given the car as a gift to the museum, and the foundation had even applied for and been granted a title to the car in 2001. In 2004, when Whittington requested the return of the car, he had to prove that he had a possessory interest in the car. Although the museum did not have a record of receiving the car as a gift or a loan, and Whittington had never applied for a tax reduction for giving the car as a gift and was able to produce one document in which he listed the car as an asset, the trial court found in favor of the foundation. The court determined that Whittington’s behavior after the museum took possession of the car was more consistent with giving the car as a gift than as a loan. The gifts we have been discussing so far have been what are called inter vivos gifts, gifts that are made by a person during his or her lifetime. Another type of gift that can be made is a gift causa mortis, a gift that is made in contemplation of one’s immediate death. It can be revoked any time before the death of the donor, and it is automatically revoked if the donor recovers. Page 182 Litigation over gifts causa mortis often arises because the three elements of delivery, donative intent, and acceptance still have to occur before the gift is complete, and that means before the death of the donor. It can sometimes be difficult to determine whether in fact all the elements of a gift causa mortis have been met. Involuntary Transfer of Personal Property Involuntary transfers of ownership occur when property has been abandoned, lost, or mislaid. The finder of such property may acquire ownership rights to such property through possession. Lost property is property that the true owner has unknowingly or accidentally dropped or left somewhere. He or she has no way of knowing how to retrieve it. In most states, the finder of lost property has title to the lost good against all except the true owner. Mislaid property differs from lost property in that the owner has intentionally placed the property somewhere but has forgotten its location. The person who owns the realty on which the mislaid property was placed has the right to hold the mislaid property. The reason is that the true owner likely will return to the realty looking for the mislaid property. In some states, the law requires that

before becoming the owner of lost or mislaid property, a finder must place an ad in the paper that will give the true owner notice that the property has been found and/or must leave the property with the police for a statutorily established reasonable period of time. Property that the original owner has discarded is abandoned property. Anyone finding such property becomes its owner by possessing it. For example, Karen is on vacation and decides that she doesn't really need her umbrella and doesn't want to carry it the rest of the trip, so she leaves the umbrella on a seat in the airport. If Bill then picks it up and takes it with him, he is now the lawful owner of the umbrella. Other Means of Acquiring Ownership of Property There are additional means by which people acquire title to property. One such means is by creation: If a person creates a piece of property, then he or she owns that property. One exception to this rule occurs when a person is paid to create property for someone else, in which case the property is owned by the person who paid for its creation. Another means of acquiring ownership is by court order. In a number of types of cases, the court will determine who is entitled to ownership of property. For example, in a divorce case, the court may award ownership of certain property to different parties, or in a bankruptcy case, the court may award ownership of certain property to a creditor. A far less common means of acquiring ownership is confusion, which involves only fungible goods. Fungible goods are goods for which one unit of the good is essentially the same as every other unit, such as grains of wheat or gallons of oil. If two people accidentally commingle their fungible goods, or if the goods are commingled because of the actions of a third party, each party is entitled to the percentage of the fungible goods that he contributed. However, if one of the parties was responsible for the commingling and that person cannot prove what percentage of the commingled goods she contributed, then the innocent party acquires title to all the goods. For example, if a farmer had stored grain in a rented storage elevator and another farmer wrongfully added his grain to the elevator, the innocent farmer would be entitled to the entire amount in the silo.

Intellectual Property LO 8-6 Describe how intellectual property law balances private and public rights. Intellectual property, property that comes from creativity, also carries a bundle of sticks, both for the creator of the property and for the community. The creators of intellectual property often want to keep the property to themselves. For example, creators of copyrighted work (creative work in a fixed form) do not want others to copy that work without permission. Page 183 At times, intellectual property is more complicated

than real property. For example, copyright often has an impact on freedom of speech. If a songwriter creates a song, others may think they have the right to express themselves through this song, but a copyright may prevent this expression. Thus, copyright law and freedom of speech sometimes clash. Legislators and courts play an important role in responding to potential conflicts. They also balance the rights of innovators who create intellectual property with the interests of the community, especially interests in competition and freedom of expression. Courts and legislators decide what sticks to set aside for creators of intellectual property. They also decide what is left for the public, including artists and other businesses. The following sections describe specific types of intellectual property. Trademarks LO 8-7 Differentiate among the methods for protecting various types of intellectual property. A trademark is a distinctive mark, word, design, picture, or arrangement that a producer uses in conjunction with a product and tends to cause consumers to identify the product with the producer. You probably recognize some of the famous trademarks in Exhibit 8-5. Even the shape of a product or package may be a trademark if it is nonfunctional. Exhibit 8-5Logos like those of McDonald's, Nike, and Coca Cola are all examples of well-known trademarks. Rose Carson/Shutterstock Even though the description of a trademark is very broad, there has still been substantial litigation over precisely what features can and cannot serve as a trademark. In one case, discussed in the Case Nugget, the U.S. Supreme Court grappled with the issue of whether a color can be a trademark. CASE Nugget Color as a Trademark? Qualitex Co. v. Jacobson Products Co. United States Supreme Court 514 U.S. 159 (1995) For years, the plaintiff, Qualitex Co., had colored the dry-cleaning press pads it manufactured a special shade of green-gold. When Jacobson Products, a competitor, started coloring its pads the same shade of green-gold, Qualitex sued Jacobson Products for trademark infringement. The defendant challenged the legitimacy of the trademark, arguing that color alone should not quality for registration as a trademark. The district court found in favor of the plaintiff, but the Ninth Circuit reversed, holding that color alone could not be registered as a trademark. The plaintiff appealed to the U.S. Supreme Court. In writing for the majority that a color could constitute a trademark, Justice Breyer said that both the language of the Lanham Act and the basic underlying principles of trademark law would seem to include color within the universe of things that could qualify as a trademark. He noted that the broad language used to describe trademarks included "any word, name, symbol, or device, or any combination thereof." Human beings might use as a symbol or device almost anything at all that is capable of carrying meaning. Justice Breyer noted that

a particular shape (of a Coca-Cola bottle), a particular sound (of NBC’s three chimes), and even a particular scent (of plumeria blossoms on sewing thread) could be trademarked, and he reasoned that if a shape, a sound, and a fragrance can act as symbols, it made sense that so could a color. He also noted that a color, if unusual enough in the context, could in fact come to identify goods with their source, just as descriptive words on a product could. The Court concluded that the green-gold color acts as a symbol that has developed secondary meaning (i.e., customers identified the green-gold color as Qualitex’s) and identifies the press pads’s source. The high court therefore reversed the decision in favor of the plaintiff. Page 184 Seventeen years later, courts considered whether a color can serve as a trademark in the fashion industry. Christian Louboutin designs and sells high-fashion shoes with red lacquered soles, and the red lacquered sole was registered as a trademark in 2008. In 2011, Yves Saint Laurent America, Inc. (YSL), planned to offer a line of monochromatic shoes whose upper part matched the color of the sole, and one of these shoes had a red upper portion along with a red sole. When Louboutin learned of the red YSL shoe, Louboutin sued YSL for trademark infringement. Relying on Qualitex, the district court held that a single color could never serve as a trademark in the fashion industry because single color marks are inherently functional. On appeal, the Second Circuit determined that there was nothing about the fashion industry that should warrant treatment different from other industries. However, the Second Circuit determined that Louboutin had put the color red “in a place that seemed unusual” (Qualitex, 514 U.S. at 162). Based on the evidence in the record, Louboutin’s trademark should be limited to a red lacquer sole that contrasts with the upper portion of the shoe. Thus, YSL was permitted to sell its monochromatic shoe.2 Today, the most well-known single-color marks are UPS’s brown mark as applied to its delivery trucks, Tiffany’s eggshell blue mark as applied to its packaging, Boise State’s blue turf, and John Deere’s green and yellow mark as applied to its various farm and industrial equipment. In all these instances, the applicant demonstrated that the mark had acquired secondary meaning. In what has been discussed as an important 2020 trademark case that may make it easier to obtain marks based on color, In Re Forney Industries, Inc.3, the D.C. Federal Circuit Court found that a distinct color-based product packaging mark can indicate the source of the goods to a consumer and, therefore, can be inherently distinctive without proof of the mark having acquired secondary meaning. The mark in question consisted of “a blending of the colors red into yellow with a black banner located near the top as applied to packaging” for metal hardware, welding equipment, safety goods, and marking products. It

remains to be seen whether this decision has any impact on the number of applicants for this type of mark. A trademark used intrastate is protected under state common law. To be protected in interstate use, the trademark must be registered with the U.S. Patent Office under the Lanham Act of 1947. If a mark is registered, the holder of the mark may recover damages from an infringer who uses it to pass off goods as being those of the mark owner. The owner may also obtain an injunction prohibiting the infringer from using the mark. (Only the latter remedy is available for an unregistered mark.) Once the mark is registered, the registration must be renewed between the fifth and sixth years. After that initial renewal, the mark holder must renew the registration every 10 years. (If the mark was initially registered before 1990, however, renewal is necessary only every 20 years.) Page 185 To register a mark with the Patent Office, one must submit a drawing of the mark and indicate when it was first used in interstate commerce and how it is used. The Patent Office conducts an investigation to verify those facts and will register a trademark as long as it is not generic, descriptive, immoral, deceptive, the name of a person whose permission has not been obtained, or substantially similar to another's trademark. While the identification of a generic term may sound straightforward, as the U.S. Supreme Court case below illustrates, sometimes changes in technology make it less easy to determine whether a term is generic. CASE 8-2 U.S. PTO v. BOOKING.COM B.V. 140 S. Ct. 2298 (2020) FACTS: Respondent Booking.com is a digital travel company that provides hotel reservations and other travel services under the brand "Booking.com," which is also the domain name of its website. Booking.com filed applications to register four marks in connection with travel-related services, each with different visual features but all containing the term "Booking.com." The U. S. Patent and Trademark Office (PTO) concluded that "Booking.com" is a generic name for online hotel-reservation services and denied them registration for the marks. Booking, they reasoned, was a generic term for making travel arrangements and .com indicated a commercial website, and so consumers would believe it referred to a class of online travel reservation systems. Alternatively, they held that even if it was descriptive and not generic, it had not acquired secondary meaning and therefore was not eligible to be registered. Booking.com sought judicial review and introduced evidence of consumers' perceptions of the term. The District Court determined that "Booking.com"—unlike the term booking standing alone—is not generic. The court found that the consuming public primarily understood that BOOKING.COM does not refer to a genus, but rather it is descriptive of services involving 'booking' available at that domain name. The Court of Appeals affirmed, finding no error in the District

Court's assessment of how consumers perceive the term “Booking.com.” The appellate court also rejected the PTO's contention that, as a rule, combining a generic term like “booking” with “.com” yields a generic composite. The PTO appealed to the U.S. Supreme Court. ISSUE: Does combining a generic term with “.com” necessarily lead to the creation of a non-registerable generic term? REASONING: The PTO's proposed rule does not follow from the established rule that adding a generic corporate designation like “Company” to a generic term does not confer trademark eligibility. While a term like company added to a generic term conveys no source information, adding.com to a generic term does in fact give source-identifying information because only one entity can occupy a particular Internet domain name at a time, so a “generic.com” term could convey to consumers an association with a particular website. Moreover, an unyielding legal rule that entirely disregards consumer perception is incompatible with a bedrock principle of the Lanham Act: The generic (or nongeneric) character of a particular term depends on its meaning to consumers. In the case of Booking.com, consumers identified the term with a specific website and not with a generic class of services providing online bookings. SIGNIFICANCE OF THIS CASE: This case is significant because it settles an important issue of whether “generic.com” is eligible for trademark protection. It also illustrates the importance of the concept of secondary meaning. CRITICAL THINKING What analogy did the high court find to be flawed? Why do you agree or disagree with the court’s view of this analogy? ETHICAL DECISION MAKING Which values are furthered by this decision? Page 186 Until 2017, the Lanham Act also banned the registration of marks that were disparaging. That year, the lead singer of an Asian American rock group challenged the decision of the PTO to not grant them a trademark for the name of their band, the Slants, because it was disparaging. While the Supreme Court did agree that the term was disparaging, they struck down the provision of the act banning registration of disparaging terms as being violative of the First Amendment.4 While some had feared that this change in the act would lead to an increase in the number of controversial trademarks being registered, those fears appear to have been unwarranted. Interestingly, the decision in this case appeared to have given the owners of the team formerly known as the Washington Redskins a basis for appealing the PTO’s decision to cancel their trademark on grounds that it was offensive to Native Americans, but they did not do so, and in fact changed their name. Recently, a number of celebrities have sought trademark protection for what some see as marks that might not really serve the purpose of identifying a product with its producer. For example, in 2015, Donald Trump received trademark protection for “Make

America Great Again.” Taylor Swift sought trademark protection for the phrases, “nice to meet you” and “where you been” on guitar picks, jewelry cases, and other consumer goods. Athletes are joining the trademark game, with football player Tim Tebow seeking to own the phrase “Tebowing,” and basketball player Jeremy Lin seeking to trademark “Linsanity.” It is sometimes difficult to determine whether a trademark will be protected. Also, once a trademark is registered, it is not always easy to predict whether a similar mark will be found to infringe on the registered trademark. The primary issue is whether consumers are likely to be confused by the two marks. This decision is based on factors such as the similarity of the marks; the similarity of the products or services in issue; the sophistication of consumers; and even the intent of the defendant to palm off its product as that of another. Case 8-3 demonstrates a typical analysis used in a trademark infringement suit. CASE 8-3 TOYS “R” US, INC. v. CANARSIE KIDDIE SHOP, INC. District Court of the Eastern District of New York 559 F. Supp. 1189 (1983) FACTS: In 1961, plaintiff Toys “R” Us, Inc., obtained a trademark for “Toys ‘R’ Us” and aggressively advertised its products, children’s toys and clothing, in stores across the country. In the late 1970s, defendant Canarsie Kiddie Shop opened two clothing shops called “Kids ‘r’ Us” within 2 miles of a Toys “R” Us shop. The defendant never tried to register its name. Toys “R” Us sued for trademark infringement in federal district court. ISSUE: Does “Kids ‘r’ Us” infringe on the “Toys ‘R’ Us” mark? REASONING: To determine the likelihood of confusion associated with the defendant’s mark, the court considered these factors: Strength of the senior user’s mark: A mark can fall into one of four general categories, which, in order of ascending strength, are (1) generic (is entitled to no protection); (2) descriptive (has a secondary meaning and informs public about uses of product); (3) suggestive (suggests qualities of product but requires imagination); and (4) arbitrary or fanciful (does not describe the qualities of the product). The plaintiff’s mark has a strong secondary meaning as a source of children’s products, so the court determines the mark has medium strength. But it falls short of the arbitrary or fanciful protection. Degree of similarity between the two marks: The key question is whether consumers have the impression that purchasing from the junior user is purchasing from the senior user. Both parties use the phrase “R Us.” However, the plaintiff uses an inverted capitalized “R,” whereas the defendant uses a noninverted lowercase “r.” The plaintiff uses “Toys” while the defendant uses “Kids.” The plaintiff’s letter is usually multicolored. Proximity of the products: Both the plaintiff and the defendant sell children’s clothing and are direct competitors. The likelihood that plaintiff will bridge the gap: First, the senior user will expand sales efforts to compete with the

junior user. Second, consumers will assume that both parties are related companies. Evidence of actual confusion: When there is proof that consumers are actually confused by the use of the name, the senior user has a stronger case. Junior user’s good faith: The owner of Kids ‘r’ Us asserted that he did not recall whether he was aware of the plaintiff’s mark. The court does not believe him and concludes that the defendant adopted the “Kids ‘r’ Us” mark with knowledge of the plaintiff’s mark. Quality of the junior user’s product: The court is much more concerned about the possible violation if the quality of the clothing is poor because such clothing would then reflect poorly on the senior user. Sophistication of the purchasers: Because children’s clothing is not a major expenditure, customers will not exercise the same degree of care in evaluating the clothes. Junior user’s goodwill: The junior user did not expend a lot of money advertising and promoting its own name. Thus, the defendant doesn’t have a strong equitable interest in retaining its name. DECISION AND REMEDY: Judgment for the plaintiff. The defendant’s use of its mark creates the likelihood of confusion and constitutes trademark infringement. SIGNIFICANCE OF THE CASE: This case clarifies the factors to consider in a trademark infringement case. CRITICAL THINKING How does this case depend to a large extent on the definitions of a few particular terms? How good are the definitions used? What standard are you using to determine whether the definitions are good? ETHICAL DECISION MAKING If you were the owner of Canarsie Kiddie Shop, Inc., how would your decision to refer to your store as “Kids ‘r’ Us” change if you were to act in accordance with the Golden Rule? What values are in conflict when considering the decisions of the owner of Canarsie Kiddie Shop, Inc., and of one who follows the Golden Rule? Page 187 The term trade dress refers to the overall appearance and image of a product. Recall that, as described in the Chapter Opener, the shape and design of Apple’s iPhone is an example of trade dress. Trade dress is entitled to the same protection as a trademark. The main focus of a case of trade-dress infringement is usually on whether there is likely to be consumer confusion. For example, in a recent case,5 Tour 18, Ltd., a golf course, copied golf holes from famous golf courses without permission of the course owners. In copying a hole from one of the most famous courses in the country, Harbour Town Hole 19, Tour 18 even copied the Harbour Town lighthouse, which is the distinctive feature of that hole. In its advertising, Tour 18 prominently featured pictures of this hole, including the lighthouse. The operator of the Harbour Town course sued Tour 18 for trade-dress infringement. The court found that there was infringement and made Tour 18 remove the lighthouse and disclaim in its advertising any affiliation with the owner of the Harbour Town course. E-COMMERCE and the

Law Domain Names and Trade Names If you have a very strong trademark, what better domain name to have than that trademark? Unfortunately, the same trademark may be owned by two companies selling noncompeting goods, yet there can be only one user of any single domain name. For example, “apple” is a trademark owned by both a computer company and the company that produces the Beatles’ records. Both cannot establish a site identified as apple.com. Domain names are important because they are the addresses by which people and businesses are located on the web. A domain name is made up of a series of domains separated by periods. Most websites have two domains. The first-level domain, the one that the address ends with, generally identifies the type of site. For example, if it is a government site, the domain name will end in gov; an educational site, in edu; a network site, in net; an organization site, in org; and a business site, in com. These top-level domain names are the same worldwide. The second-level domain is usually the name of whoever maintains the site. For a college, for example, it would be an abbreviation of the college name, such as bgsu. Businesses generally want to use their firm name or some other trademark associated with their product because that name will obviously make it easiest for their customers to find them. So how does a firm go about securing a domain name that reflects its trademark? Network Solutions, Inc. (NSI), which is funded by the National Science Foundation, is responsible for registering domain names. This entity acts on behalf of the Internet Network Information Center, which handles the daily administration of the domain name system in the United States. Initially, a person applied to the NSI to use a specific domain name, and as long as no one else held that name, registration was granted. Since 1995, however, the NSI has been a little more careful in handing out names. Anyone seeking to register a domain name must now state in the application that the name will not infringe on anyone else’s intellectual property rights and that the registrant intends to use the name on a regular basis on the Internet. A party may lose registration of a name by not using it for more than 90 days. Or the domain name may be canceled if the registrant lied on the registration application. If you have a registered trademark and you find that a party is using your trademark as a domain name and that party does not also have ownership of that mark, you may give written notice to the NSI; under its domain dispute policy, it will most likely put the name on hold, meaning that no one can use the name. Of course, if that party had registered its domain name before you obtained the trademark, there is probably nothing you can do. The party will be entitled to retain the domain name. Some firms have tried to get the domain name they desire by going to another country. That alternative is certainly a possibility.

However, many countries require your firm to be incorporated within their borders before you can gain the right to the domain name there. An additional problem is that trademark law relating to domain names is even more unclear abroad. For the new entrepreneur, the best advice is to apply for federal trademark protection and register the domain name simultaneously. And for those not yet on the web, the sooner you get your domain name, the more likely you are to get the name you want. If you feel that your mark is being violated by another's domain name, you may want to sue the party for infringement because the unauthorized use of another's trademark in a domain name has been found to be illegal. But you may be in for quite a fight because this is a new area of the law. Copyrights Copyrights protect the expression of creative ideas. That is, they do not protect the ideas themselves but protect only the fixed form that expresses the ideas. Copyrights protect a diverse range of creative works, such as books, periodicals, musical compositions, plays, motion pictures, sound recordings, lectures, works of art, and computer programs. Titles and short phrases may not be copyrighted. Page 188 There are three criteria for a work to be copyrightable. First, it must be fixed, which means set out in a tangible medium of expression. Second, it must be original. Third, it must be creative. A copyright automatically arises under common law when the idea is expressed in tangible form. However, if the work is freely distributed without notice of copyright, the work falls into the public domain. A copyrighted work that is reproduced with the appropriate notice affixed is protected for the life of its creator plus 70 years. Under the common law of copyright, an infringer may be enjoined only from reproducing a copyrighted work. For the creator to be able not only to seek an injunction but also recover damages arising from the infringement, the copyrighted work must be registered. One may register a work by filing a form with the Register of Copyrights and providing two copies of the copyrighted material to the Library of Congress. Whenever the work is reproduced, the appropriate notice of copyright should accompany it, although such notice is no longer required by law. Printed works, for example, should be published with the word copyright and the symbol © or the abbreviation copr., followed by the first date of publication and the name of the copyright owner. Once the work is registered, as long as it is always accompanied by the notice of copyright when reproduced, the holder of the copyright has the additional right to sue an infringer for damages caused by the infringer's use of the copyrighted material and to recover any profits made by the infringer on the copyrighted material. Page 189 It is not always easy to determine whether a copyright has been infringed, even when two works are similar. After all, if we are talking about

creative works, such as photographs of a famous scene, two people might independently take a very similar picture at completely different times and without even knowing of each other's work. The following Case Nugget illustrates the court's reasoning in a successful copyright infringement case. CASE Nugget A Question of Whether There Was Copying Ty, Inc. v. GMA Accessories, Inc. U.S. Court of Appeals, Seventh Circuit 45 U.S.P.Q. 1519 (1998) Ty began selling Beanie Babies, and then GMA started selling bean-bag stuffed animals three years later. Ty sought an injunction under the Copyright Act to stop the sale of GMA's Preston the Pig and Louie the Cow. Ty argued that these animals violated its copyrights for Squealer (a pig) and Daisy (a cow). Ty was successful in obtaining an injunction for copyright after the court asked the following questions: Did the alleged copier have access to the work he or she potentially copied? Did he or she actually copy the work? The court found that access (and copying) may be inferred when the two works are so similar and unlike anything in the public domain that it is likely the second user copied the first. This inference can be rebutted by disproving access or showing independent creation. Looking at pictures of the two cows compels an inference of copying. If GMA must have had access to Ty's cow, it must have had access to the pig, too. GMA's pig is strikingly similar to Ty's pig but not to anything in the public domain (e.g., a real pig). The only evidence GMA presented was an affidavit by the designer, who swears she never looked at Squealer. However, the actual bean-bag animal looks more like Ty's design than the designer's drawing. The fair-use doctrine provides that a portion of a copyrighted work may be reproduced for purposes of "criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarships, and research." In determining whether the fair-use doctrine provides a valid defense to a claim of copyright infringement, Section 107 of the Copyright Act requires the court to weigh the following four factors: the purpose and character of the use, the nature of the copyrighted work, the amount and substantiality of the portion used in relation to the copyrighted work as a whole, and the effect of the use on the potential market for or value of the copyrighted work. E-COMMERCE and the Law Changes to Copyright Law as Technology Evolves Copyright law has also undergone multiple changes as new ways to reproduce and distribute copyrighted content multiply alongside frequent new developments in technology. For example, in 2014's Broadcasting Cos. v. Aereo, Inc.,6 the Supreme Court had to decide whether or not a new twist on an old technology was violating copyright laws. To understand the case, one must first understand the technology Aereo was using. Aereo had set up banks of tiny digital antennas that would receive over-the-air television

signals that were being broadcast by television companies. A computer attached to each antenna would then make a copy of the signal's data and then transmit this data to an Aereo user. This allowed Aereo subscribers to watch television shows on non-television devices using the Internet. While Aereo users paid for the service, Aereo did not pay the company that originally broadcast the copyrighted material. Aereo argued that because it created a unique, separate copy of a transmission for each user, and each copy was being sent to one user only, Aereo was not creating a "public performance" and therefore was not infringing on the broadcasters' copyrights. In his majority opinion, Justice Breyer disagreed, saying that Aereo "performed" by transmitting and that the "performance" was indeed public because, "when Aereo streams the same television program to multiple subscribers, it transmits . . . a performance to all of them." This type of case has become increasingly common in an age where communication technology is constantly evolving. In the 1970s, Sony developed a format for videotaping called Betamax. Film studios brought suit against Sony in 1976, arguing that taping a television show was copyright infringement. The district court concluded that recording a show for personal, noncommercial use was fair use, but the appellate court disagreed and found Sony liable. The Supreme Court ultimately ruled on this issue in 1984, agreeing that recording a television program for the noncommercial purpose of time shifting is fair use.7 Page 190 In 1994, the Supreme Court decided that commercial parody may be fair use. In that case, 2 Live Crew, a rap group known for its explicit lyrics, recorded and released a song called "Pretty Woman," which was a parody of Roy Orbison's "Oh, Pretty Woman." The Supreme Court considered the four factors listed previously. With respect to the purpose and character of the use, the more transformative the new work is, the less courts will need to focus on the other three factors. As technology has continued to develop, copyright enforcement has remained an important concern. For example, Napster was a peer-to-peer file sharing network by which one user could download a file from another user for free. Files that were typically transferred were digital music files. The record industry brought suit against Napster and received a preliminary injunction to stop the exchange of digital music files. Napster appealed to the Ninth Circuit Court of Appeals, which affirmed the preliminary injunction.8 Napster made several arguments regarding fair use. Like the time-shifting purpose in the Betamax case, Napster argued that users were engaging in space shifting (i.e., transferring music files from CDs they had purchased to their computers). However, the court found that although the user may have been transferring the format (from CD to computer file) for personal use, the user

was necessarily sharing the files with other users, which was not a fair use. GLOBAL Context Digital Archive Japan/Alamy Stock Photo Comparing the Law of Other Countries: The EU's General Data Protection Regulation The General Data Protection Regulation (GDPR) is a European Union (EU)-wide law that protects an individ-ual's ("data subject") personal data that took effect on May 25, 2018. The GDPR applies to EU-based businesses and any non-EU entity that offers goods or services to individuals in the EU. This includes U.S. firms doing business in the EU. Among various mandates, the GDPR gives individuals the right to access any personal data col-lected. The GDPR also prohibits companies from gath-ering, keeping, and communicating personal data about individuals without valid legal grounds or a data subject's explicit consent. Firms that violate the GDPR can be fined the greater amount between €20 million or 4 percent of annual revenue. The GDPR poses several issues for the U.S. intellectual property field. A patent attorney will have to collect and submit personal information, such as the name of the inven-tor, to file a patent. While it seems unlikely that an inventor would not consent to have personal information used that way, the GDPR allows an individual to withdraw consent at any time. The GDPR classifies data-users "controllers" and "processors." Controllers determine the purpose of processing the data and have higher standards. When an IP attorney files an application for their client, who is the controller and who is the processor of the inventor's personal data? One of the biggest challenges in enforcing IP rights is identifying the infringer. Typically, an IP-rights holder will ask internet service providers or domain name registrars for information such as IP addresses and email addresses, which are considered personal data under the GDPR. Because information necessary to catch IP-infringers can be personal data, IP-rights holders may face delays or incomplete data when requesting it from EU organizations. However, under EU Directive 2004/48 on the enforcement of intellectual property rights, national courts may grant orders to provide personal data. Finally, a question remains as to where personal data ends and where intellectual property begins. Under the GDPR's right of access, a French journalist asked Tinder for her personal data—and got back 800 pages of it. The data included matters such as every message the journalist ever sent, what she liked on Instagram and Facebook, and the percentage of different races she matched. Nevertheless, the data did not include how Tinder personalized the data. When pressed, Tinder refused to give the journalist access, stating, "[o]ur matching tools are a core party of our technology and intellectual property."9 Exhibit 8-6Trademark and copyright symbols HOW DO I KNOW IF AN IMAGE HAS BEEN PROTECTED BY A TRADEMARK OR COPYRIGHT? Images that have been legally deemed a

trademark or copyright protected often include small indications that the image in question is not available for public use. The absence of such symbols, however, should not be relied upon to definitively indicate that the image is not protected. These indicators include • The copyright symbol: © • The trademark symbol: ™ • The registered trademark symbol: ® Patents A patent protects a product, process, invention, machine, or a plant produced by asexual reproduction. For this protection to be granted, three criteria must be satisfied. First, the object of the patent must be novel, or new. No one else must have previously made or published the plans for this object. Second, the object must be useful unless it is a design. It must provide some utility to society. Third, the object must be nonobvious. The invention must not be one that a person of ordinary skill in the trade could have easily discovered. When a patent is issued for an object, it gives its holder the exclusive right to produce, sell, and use the object of the patent for 20 years from the date of application. The holder of the patent may license, or allow others to manufacture and sell, the patented object. In most cases, patents are licensed in exchange for the payment of royalties, a sum of money paid for each use of the patented process. Page 191 BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? What if Samsung had presented evidence at the trial that half of the phones on the market at the time of the trial that were made by companies other than Apple or Samsung also shared the iPhone’s design of being rectangular with rounded corners? Page 192 The only restriction on the patent holder is that he or she may not use the patent for an illegal purpose. The two most common illegal purposes are tying arrangements and cross-licensing. A tying arrangement occurs when the holder issues a license to use the patented object only if the licensee agrees to buy some nonpatented product from the holder. Cross-licensing occurs when two patent holders license each other to use their patents only on the condition that neither licenses anyone else to use his or her patent without the other’s consent. Both of these activities are unlawful because they tend to reduce competition. To obtain a patent, one generally contacts an attorney licensed to practice before the U.S. Patent Office. The attorney does a patent search to make sure that no similar patent exists. If none exist, the attorney fills out a patent application and files it with the Patent Office. As part of the application process, the inventor has a duty to disclose any prior art he or she is aware of related to the invention, including other patents. The Patent Office evaluates the application, and if the object meets the criteria already described, a patent is issued within approximately two years. Although two years may seem like a long time, it is short compared to the six years it typically takes to secure a patent in Japan. Once

the patent is issued, the holder may bring a patent infringement suit in a federal court against anyone who uses, sells, or manufactures the patented invention without the permission of the patent holder. A successful action may result in an injunction prohibiting further use of the patented item by the infringer and an award of damages. Sometimes, however, the result of the case is that the holder loses the patent. This loss would occur if the infringer can prove that the Patent Office should not have issued the patent in the first place. Another way in which a potential patent infringer may attempt to challenge a patent is to ask the United States Patent and Trademark Office (USPTO) to reexamine the patent. Through the reexamination process, a party presents what it argues is invalidating prior art (i.e., patents, articles, or products that disclosed all features of the invention before the patent-at-issue was granted). The USPTO then considers whether the patent should have, in fact, been issued. Reexamination requests are frequently granted, and it may take several years for the USPTO to consider whether a patent should have been issued. Thus, reexaminations are tools defendants frequently use to slow down or even pause litigation because a court may prefer the USPTO to complete the reexamination before litigation may proceed. BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? What if Samsung had been able to bring in evidence that Samsung, in fact, sold a phone with a design similar to the iPhone’s before the iPhone had come out? Would that fact have affected the outcome of the case with respect to Apple’s claim of infringement on its design patent? The America Invents Act In 2011, Congress passed the America Invents Act, which changed the U.S. patent system in several important ways. First, the first person to file a patent application in the United States for an invention will be deemed to have rights to the invention. This is a change from the previous policy, by which the first person to invent had the rights to the invention. This change is important because in the past, employees could keep diligent records and take their time applying for the patent. The European and Japanese patent systems also have a first-to-file rule. Second, the act expands the types of prior art that may be considered by the USPTO when granting a patent, which would arguably make it more difficult to obtain a patent. Third, the act makes changes to the reexamination process, making the process more like litigation by allowing discovery requests during the process. Fourth, the act prohibits a plaintiff from filing one suit against many unrelated defendants, which has typically increased the number of patent infringement cases filed. Finally, the act makes it easier and more affordable for small businesses and sole entrepreneurs to apply for patents. Page 193 Trade Secrets A trade secret is

a process, product, method of operation, or compilation of information that gives a businessperson an advantage over competitors. Inventions and designs may also be considered trade secrets. Furthermore, a company's client list (or an employee's contact list) could be considered a trade secret. A trade secret is protected by the common law from unlawful appropriation by competitors as long as it is kept secret and consists of elements not generally known in the trade. Competitors may discover a secret by any lawful means, such as by doing reverse engineering or by going on public tours of plants and observing the use of trade secrets. Lawful discovery of a secret means there is no longer a trade secret to be protected. When an employee leaves a company to work for a competing company, the original company frequently investigates whether the employee has taken any trade secrets to the competitor. According to one study, 59 percent of departing employees take confidential information from the employer when leaving.10 To ensure that confidential information is protected, companies should consider creating a policy stipulating that any trade secret information must be labeled Confidential or Trade Secret by employees (which would help the employer maintain a trade secret claim) and limit access to this confidential information within the company. If a competitor acquires a trade secret by unlawful means, the originator of the secret can take legal action. To enjoin such a competitor from continuing the use of a trade secret and/or to recover damages caused by the use of the secret, a plaintiff must prove that a trade secret actually existed, that the defendant acquired it through unlawful means, and that the defendant used the trade secret without the plaintiff's permission. A common dilemma facing an inventor is whether to protect an invention through patent or trade-secret law. If the inventor successfully patents the invention and defends the patent, the inventor has a guaranteed exclusive monopoly on the use of the invention for 20 years, a substantial period of time. The problem is that once this period is over, the patented good goes into the public domain and everyone has access to it. There is also the risk that the patent may be successfully challenged and the protection lost prematurely. Trade-secret law, on the other hand, could protect the invention in perpetuity. The problem is that once someone discovers the secret lawfully, the protection is lost. CASE OPENER WRAP-UP Smartphone Wars: Focus on Intellectual Property Rights In August 2012, Apple and Samsung participated in a four-week jury trial regarding patent infringement and trademark claims. Both Apple and Samsung asserted patents in this trial; however, the jury found that (1) Samsung infringed Apple's patents, (2) Apple did not infringe Samsung's patents, and (3) the trade dress of Apple's iPhone was diluted by some of Samsung's products.

The jury awarded Apple over $1 billion in damages, which was one of the highest patent infringement awards in history. Prior to the trial, the judge issued a preliminary injunction that prevented Samsung from selling one of its tablets. However, following the trial, the injunction was lifted. Page 194 PRACTICAL TIPS for Business Managers Before starting a business in a certain area of your city, be sure to learn about the local zoning ordinances to ensure that it is even legal to operate a business in that part of town in the first place. This tip is especially important if you decide to run a business out of your home; many zoning laws do not allow businesses in residential areas except under very particular circumstances. When deciding to start a new business, you need to decide whether to lease or purchase the real property on which you pan to do business. The answer to this question relies on several factors. Do you think your business will outgrow the space? Do you want to deal with maintaining the property? How long do you intend to operate your business on that property? As a rule of thumb, it is generally cheaper in the long run to buy if you plan to operate a business on a piece of property for longer than seven years. If you or an employee invent a new piece of intellectual property, it is very important that you patent it, register it as a trademark, or receive copyright protections as soon as possible. Failure to do so could lead to a competitor learning about the idea, beating you to the Patent and Trademark Office, and profiting from your idea. Be sure to keep intellectual property currently in development a secret. Hire employees you can trust, and enforce strict internal security policies to ensure that your competitors do not learn about your ideas and secure a patent before you can. Remember that, once you secure a trademark, it is your duty to uphold its uniqueness by preventing dilution and actively fighting against parties that use the trademark without permission. Failure to do so can result in the abandonment of the trademark, meaning your firm no longer holds the rights to the mark.

SUMMARY The Nature of Real and Intellectual Property Real property is land and anything permanently affixed to the land. Intellectual property is property that is primarily the result of mental creativity rather than physical effort. Real Property Fee simple absolute: Right to possess for life and devise to heirs on death; the most encompassing interest. Conditional estate: Right that is comparable to a fee simple absolute except that the interest will terminate on the happening or nonhappening of a specified condition. Leasehold estate: Right to possess property for an agreed-on period of time. Easement: Irrevocable right to use a portion of someone else’s land for a

specified purpose. License: Right to use another’s property temporarily. Personal property Personal property is all property that is not land or permanently affixed to land. Voluntary transfer of personal property: Property can be transferred by purchase or by gift. Involuntary transfer of property: If property is lost, mislaid, or abandoned, a new owner acquires title to the property through possession. Intellectual Property A trademark is a distinctive mark, word, design, picture, or arrangement that a producer uses in conjunction with a product and tends to cause the consumer to identify the product with the producer. Trademarks used in interstate commerce can be protected under the Lanham Act. A copyright protects the fixed form of the expression of an original, creative idea. The most common defense to an allegation of copyright infringement is the fair-use doctrine, which provides that a portion of a copyrighted work may be reproduced for purposes of “criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarships, and research.” A patent protects a product, process, invention, machine, or plant produced by asexual reproduction that meets the criteria of being novel, useful, and nonobvious. Obtaining a patent under the Lanham Act allows the holder to license the use of his or her patented idea for royalties as long as the holder does not enter into a tying arrangement or engage in cross-licensing.

Point/Counterpoint The process of applying for a patent and keeping a patent can be difficult and costly. As you know, an alternative to patenting an invention is to protect it through trade-secret law. Should Corporations Be Allowed to Patent Genes? YES NO While they are often not the first thing that comes to mind when considering intellectual property, most synthetic genes are allowed to be patented. The patenting of genes brings with it many benefits for both businesses and consumers. First of all, allowing a business to patent a gene gives the firm exclusive rights to look at and experiment with the gene for the patent’s duration. This exclusivity means that the firm with the patented gene would have ample time to examine the gene and develop its usefulness to the fullest without worrying about a competitor beating them to market with a product based on the gene. The time allowed by the patent may also help small businesses that discover a particular synthetic gene compete against larger businesses that would otherwise have the resources to always beat out the smaller company. Another benefit of gene patenting is that the promise of exclusive rights to a synthetic gene sequence could spur innovation. As with most other industries, gene patents would protect the rights of innovators and guarantee that the time and

resources spent developing a test or drug from a gene won’t be undercut by a competitor. The potential increase in innovation could lead to a greater quantity and quality of discoveries brought upon by researching the genes. Finally, gene patents make what is normally an unprofitable area of research potentially profitable. Without the patents, there is nothing stopping a competitor from releasing a generic version of a drug or treatment developed by a firm after studying a gene. Not only would the patents help secure profits for innovating firms and therefore provide more incentive to pursue gene research, but the higher likelihood of profits could also mean more people would be willing to invest in gene research. Increased investment could lead to a cycle of better gene-derived products, which means higher profits, which again could mean more investment. While the Supreme Court has ruled that naturally occurring human genes cannot be patented, it has allowed for synthetic genes not found in nature to be patented. However there are several reasons why even the patenting of synthetic genes goes too far. First, exclusive rights to a synthetic gene and the products derived from the gene means no competition. A lack of competition can, in turn, lead to arbitrarily high prices that consumers have to pay if they wish to treat an illness that can only be cured by a product that a single firm holds the rights to. People who could not afford treatment could very well die before the patent expires and another company can provide a cheaper alternative. Second, allowing only one company to interact with a particular gene simply means fewer individuals working with the gene and could therefore slow down innovation as a whole in regards to developing products with said gene. Gene patenting also effectively puts one firm in control of a gene, and whether or not cures or life-improving products are developed for consumers who need them is decided entirely by that single business for the duration of the patent. Third, because naturally occurring genes are not allowed to be patented while synthetic genes are, there could be a massive shift away from studying natural human genes toward the more profitable synthetic genes. While there are many breakthroughs to be had in the realm of synthetic genes, there are still many important discoveries to be made in the natural genes area as well.

Questions & Problems Explain the bundle-of-sticks idea as it relates to real property. Explain the five possessory interests in land. Explain the bundle-of-sticks idea as it relates to intellectual property. How are trademarks and patents different? Explain copyright infringement. Page 196 On September 8, 2011, John Barth purchased a piece of property at 4 Lynn Street in Peabody,

Massachusetts, for $1,000. Barth subsequently requested the City of Peabody to grant a variance to exempt his property from the local zoning ordinance. The City of Peabody's Zoning Board of Appeals held a public hearing and later voted to deny the variance. Following the refusal, Barth filed a pro se complaint alleging 23 "violations of law." Of the many claims Barth made, he specifically argued that the denial of his zoning variance request constituted a violation of the Fifth Amendment's Taking Clause. Barth contended that the denial amounted to a taking because it deprived him of the use and enjoyment of the land. Do you think the denial of the variance could legally be considered a taking? Source: Barth v. City of Peabody, U.S. Dist. LEXIS 4080 (2017). Adrian Samalia fled a stolen vehicle during a lawful traffic stop. While Samalia successfully escaped, he left his cell phone in the stolen vehicle. Police officers searched the cell phone without a warrant and used the information contained in it to confirm Samalia's identification. The data from the phone was used as evidence in a trial against Samalia for possession of a stolen vehicle. Samalia moved to suppress the evidence, arguing that his constitutional rights were violated when they searched the phone without a warrant. The State contended that the warrantless search was allowed under the abandonment doctrine. The trial court denied the motion to suppress and eventually found Samalia guilty. After a series of appeals, the case worked its way up to the Supreme Court of the State of Washington. Under the abandonment doctrine, an individual loses his or her privacy interest in a property if he or she voluntarily abandons it. While Samalia argued that the abandonment doctrine should not be applicable to cell phones because they hold "private affairs," the Washington Supreme Court ruled that there would be no exception to the abandonment doctrine for cell phones. At this point for the State to prevail, it had to show that Samalia voluntarily abandoned his cell phone. Do you think the cell phone left by Samalia as he ran from the police was voluntarily abandoned? Explain why or why not. How did the Washington Supreme Court rule on this issue and what was its reasoning? Do you agree? Why or why not? Source: State v. Samalia, 375 P. 3d 1082 (2017). Thomas Garrison transferred title on two cars to one of his sons, Jay Garrison, while on his deathbed. After Thomas passed, his widow Pamela Garrison filed a petition to recover the cars as the representative of the estate. Pamela challenged Thomas's competency to make inter vivos gifts of the cars. The trial court ruled that the cars were actually gifts causa mortis and concluded that the evidence of Thomas's competency to make such a gift was evenly split. Because the evidence was equal, the trial court ruled the cars had to be returned to the estate. Jay appealed the decision, contending that the trial court should have concluded

the cars were a gift inter vivos and not a gift causa mortis. The type of gift matters because different standards apply for each one. According to the appellate court, the burden of showing whether a gift qualifies as an inter vivos gift is a preponderance of the evidence. On the other hand, evidence must be clear and convincing to establish a gift as a gift causa mortis. Why do you think the standard for the gift causa mortis is more stringent than for the inter vivos gift? Source: Garrison v. Garrison, 71 NE 3d 423 (2017). Stone Brewing Co. is a San Diego brewer that has maintained its trademark and brand from the beginning, registering the STONE mark in 1998. Since 1989, Miller has sold the Keystone brand of beers. In 2017, Miller undertook efforts to “refresh” its Keystone image by updating the can and package design. The new can design took “KEYSTONE” and separated “KEY” and “STONE” onto separate lines. The packaging emphasized “STONE” rather than “KEYSTONE.” Alongside the redesign, Miller introduced a new ad campaign with the slogan “Hunt the STONE.” Do you believe that MillerCoors’ use of the “KEYSTONE” mark infringe on Stone’s “STONE” mark? Source: Stone Brewing Co. v. MillerCoors, LLC, Dist. Court, SD California, 2019 U.S. District Lexis 52153. When William S. Thrasher died, he left a life estate in the family home to his wife, Gail Thrasher, and a remainder interest to his children, James Hall Thrasher and Sheila Reed. When Gail attempted to sell her life estate, the children sued, arguing that by selling the life estate, she was forfeiting the life estate because the buyer might waste the property, thereby devaluing the interests of the children. How do you think the courts resolved this issue? Should the holder of the life estate be able to transfer the life estate? Source: Thrasher v. Thrasher, 169 So. 3d 1043; 2014 Ala. Civ. App. LEXIS (2014). Page 197 Beyoncé Knowles-Carter (“Beyoncé”) is a world-renowned music artist who is among the best-known figures in entertainment. Plaintiff BGK Trademark Holdings, LLC (“BGK”), is the owner of the federally registered trademark BEYONCÉ. Products that feature the BEYONCÉ mark are sold on the website Vargas Deck. Andre Maurice and Leana Lopez operate a business that sells clothing and apparel with the mark FEYONCÉ and certain phrases from Beyoncé’s well-known songs. After beginning to use the mark FEYONCÉ in commerce in at least March of 2016, defendants sold clothing items until at least October 26, 2016. From at least January 15, 2017, through May 15, 2017, defendants sold similar items on Etsy.com through a shop called “FeyonceShop.” On February 22, 2015, counsel for plaintiffs sent a cease-and-desist letter to defendant Maurice demanding that defendants stop using the FEYONCÉ mark, abandon their trademark applications, and transfer the domain name to plaintiffs. Not receiving a response, on April 5, 2016, plaintiffs filed a complaint against

defendants Maurice and Lopez, in addition to Lee Lee and Feyonce, Inc., asserting causes of action for Federal Trademark Infringement. Do you believe Feyonce infringed upon the BEYONCÉ mark? Source: Knowles-Carter v. Feyonce, Inc., 347 F. Supp. 3d 217 (S.D.N.Y. 2018). The plaintiff sold his photography online. He sued defendants for copyright infringement. He believed that the defendants had obtained his photos illegally and placed one of these photographs, without the plaintiff's permission, on a commercial Internet website they operated. After the defendants ignored a letter by the plaintiff demanding that the online photos be taken down, the plaintiff filed a copyright infringement case seeking $30,000 in damages. The owner also alleged that the defendants' conduct constituted a willful violation of his copyrights. The court considered the following factors in determining whether a damages remedy existed: the infringer's state of mind; the expenses saved by the infringer; the revenue lost by the copyright holder; the deterrent effect on the infringer and third parties; the infringer's cooperation in the case; and the attitude and conduct of the parties. Based on the allegations stated above, do you believe that these factors merit a damages reward of $30,000? In whose favor do you believe the court ruled? Explain your reasoning. Source: Oppenheimer v. Holt, No. 1:14-CV-000208-MR, 2015 WL 2062189 (W.D.N.C. May 4, 2015). Securities brokerage firm Charles Schwab filed suit against a former employee who left the company and started his own wealth management firm. Charles Schwab claimed that the names of its clients, along with information regarding their accounts and assets, were trade secrets. The employee therefore misappropriated these trade secrets when he contacted the clients to ask them to transfer their accounts to his new firm. Charles Schwab argued that the employee could not have learned of these individuals but for his work at the Charles Schwab brokerage. Do you think this customer information will be treated as a trade secret? What factors do you think the court will consider when determining whether the customer information is a trade secret? Source: Charles Schwab & Co. Inc. v. Douglas Castro, Case No. 650053/2013 (E.D.N.Y. January 7, 2013). Lynn Goldsmith is a photographer known for her photographs of famous musicians. In 1981, Goldsmith had a photography session with the singer Prince. Three years later, Vanity Fair obtained a license from Goldsmith's photography agency to use one of Goldsmith's Prince photographs "as an artist's reference in connection with an article to be published in Vanity Fair magazine." At the time, Goldsmith was not aware that her agency had licensed the photo graph. Vanity Fair commissioned Andy Warhol to create an illustration for an article about Prince. Warhol produced an illustration based on Goldsmith's licensed photograph, which

was used in the published article. Warhol would go on to create the “Prince Series,” composed of 16 different pieces of artwork, including the illustration used in the Vanity Fair article. Following Prince’s death in 2016, Vanity Fair published an online copy of its 1984 article and a commemorative issue entitled “The Genius of Prince.” Vanity Fair obtained a license from Warhol’s estate to use the Prince Series works on the cover of the issue. The issue displayed a copyright credit to Warhol, not Goldsmith. Goldsmith saw the issue, and it was here that she first learned about Warhol’s artwork. Goldsmith accused Warhol’s estate of copyright infringement for using her photograph as the basis of the Prince Series. Warhol’s estate moved to dismiss the claim, arguing that Warhol’s use of the photograph was protected under fair use. What factors do you think the court considered in determining whether Warhol’s artwork was protected by fair use? Source: The Andy Warhol Foundation for the Visual Arts v. Goldsmith,Case 1:17-cv-02532-JGK (S.D.N.Y. August 1, 2019).

Part 2 Contract Law CHAPTER 9 Introduction to Contracts and Agreement Page 198 CASE OPENER The Problematic Promotion Pepsi had a promotion whereby consumers were encouraged to collect Pepsi points by consuming Pepsi products. They could then redeem the points for merchandise. If they did not have quite enough points for the prize they wanted, they could buy the needed additional points for 10 cents each; however, at least 15 original Pepsi points had to accompany each order. At the climax of an early commercial for the promotion, three young boys are sitting in front of a high school building, one reading his Pepsi Stuff catalog while the others drink Pepsi, all gazing in awe at an object rushing overhead as the military march in the background builds to a crescendo. A Harrier jet swings into view and lands by the side of the school building, next to a bicycle rack. Several students run for cover, and the velocity of the wind strips one hapless faculty member down to his underwear. While the faculty member is being deprived of his dignity, the voice-over announces: “Now the more Pepsi you drink, the more great stuff you’re gonna get.” A teenager opens the cockpit of the fighter and can be seen, without a helmet, holding a Pepsi. He exclaims, “Sure beats the bus,” and chortles. The military drumroll sounds a final time, as the following words appear: “Harrier Fighter 7,000,000 Pepsi Points.” A few seconds later, the following appears in more stylized script: “Drink Pepsi —Get Stuff.” John Leonard decided to accept Pepsi’s offer of the Harrier

fighter jet for 7 million Pepsi points. He quickly realized that it would be easier to raise the money to buy points than to collect the 7 million points. In early March 1996, he filled out an order form requesting the jet and submitted it to Pepsi, along with 15 Pepsi points and a check for $700,000. In response, Pepsi sent him a letter saying, “The item that you have requested is not part of the Pepsi Stuff collection. It is not included in the catalog or on the order form, and only catalog merchandise can be redeemed under this program.” John then sued for breach of contract. Did Pepsi offer to sell the Harrier jet for 7 million points? Did Leonard’s submission of the order form constitute an acceptance? Was the alleged contract in this case a bilateral or unilateral contract? Page 199 LEARNING OBJECTIVES LO 9-1 Describe what a contract is. LO 9-2 Integrate common law and UCC. LO 9-3 Distinguish between bilateral and unilateral contracts. LO 9-4 Distinguish express from implied-in-fact contracts. LO 9-5 Distinguish void, voidable, and valid contracts. LO 9-6 Distinguish executed from executory contracts. LO 9-7 Identify elements of a valid offer and a valid acceptance. LO 9-8 Explain how an offer may terminate.

The Definition of a Contract LO 9-1 Describe what a contract is. This part of the text focuses on contracts. A contract, according to the Restatement (Second) of Contracts, is “a promise or set of promises for the breach of which the law gives a remedy or the performance of which the law in some way recognizes a duty.”1 Another, perhaps simpler, way to think of a contract is that it is a set of legally enforceable promises. Elements of a Contract A contract has four elements: the agreement, the consideration, contractual capacity, and a legal object. The agreement consists of an offer by one party, called the offeror, to enter into a contract, and an acceptance of the terms of the offer by the other party, called the offeree. The agreement is discussed in more detail in the latter part of this chapter. The second element of a contract is the consideration, which is defined as the bargained-for exchange. Another way to think of the consideration is that it is what each party gets in exchange for his or her promise under the contract. Consideration is further discussed in Chapter 10. The third element is contractual capacity, the legal ability to enter into a binding agreement. Most adults over the age of majority have the legal ability to enter into binding contracts, but Chapter 10 explains when people have either limited or no capacity to enter into these agreements. Persons who do not have the capacity to enter into legally binding contracts include those who are under the age of majority, intoxicated, or suffering from mental illness. Chapter 10

also discusses the fourth element of a binding, legal contract: legal object. The contract cannot be either illegal or against public policy. The elements of a contract, as well as defenses to its enforcement, are listed in Exhibit 9-1. Exhibit 9-1A Valid Contract Has Four Elements, and No Defenses Can Be Raised against It ELEMENTS OF A CONTRACT DEFENSES TO A CONTRACT Agreement Lack of genuine assent Consideration Lack of proper form Legal purpose Capacity Page 200 Defenses to the Enforcement of a Contract Sometimes the parties may enter into what appears to be a legally binding and enforceable contract because all four elements of a contract are present, but one of the parties may have a defense to the contract's enforcement. Such defenses fall into two categories. The first, discussed in Chapter 12, is a lack of genuine assent. A contract is supposed to be entered into freely by both parties, but sometimes the offeror secures the acceptance of the agreement through improper means, such as fraud, duress, undue influence, or misrepresentation. In these situations, there really is no genuine assent to the contract, and the offeree may be able to raise the lack of genuine assent as a defense to enforcement of the agreement. The second defense, discussed in Chapter 13, is that the contract lacks the proper form, which typically means it lacks a writing. Certain contracts require a writing, and if there is none, the agreement will not be enforced. Chapter 14 discusses the performance and discharge of contracts as well as remedies arising when a contract is breached.

Sources of Contract Law LO 9-2 Integrate common law and UCC. There are two primary sources of contract law: case law and the Uniform Commercial Code (UCC). A third source of law, which has become more important with increasing globalization, is the Convention on Contracts for International Sales of Goods (CISG). Chapters 9 through 14 of this book focus primarily on the law of contracts as established by the common law, and Chapters 15 and 16 focus on the law as established by the UCC and CSIG. Common Law Today's law of contracts actually originated in judicial decisions in England, which were followed by the early courts in the United States. Since then, contract law has been modified by our legislatures and by rulings of our courts. The law of contracts is primarily common law, so to find out what the law is, one could go to the Reporters and read the decisions, but an easier way to know the law would be to go to the Restatement (Second) of the Law of Contracts. Prominent legal scholars, recruited by the American Law Institute, organized the principles of the common law of contracts into the original Restatement of the Law, Contracts. The compilation has

subsequently been revised and published as Restatement of the Law Second, Contracts. The Restatement (Second) is not actually the law itself, although judges frequently cite it in cases because it is an authoritative statement of what the law is. As the common law of contracts evolved in the various states, not all states interpreted all aspects of the law in the same way, so although we can generalize about the law of contracts, one would of course always want to know exactly what the law at issue is in one's own state. In the Restatement (Second), the drafters often explain what the law about a particular matter is in the majority of states and then provide alternative approaches that other states have adopted. Uniform Commercial Code Having different laws governing contracts in different states did not make interstate commerce flow smoothly. To remedy some of the difficulties created by a patchwork of different laws governing commercial transactions, the National Conference of Commissioners on Uniform State Laws and the American Law Institute drafted a set of commercial laws that could be applicable to all states. This effort was called the Uniform Commercial Code (UCC). The UCC became law in each state that adopted it completely or partially as part of its state code. Thus, for example, if a firm enters into a contract governed by the Uniform Commercial Code in Ohio, it would be operating under the Ohio Uniform Commercial Code. GLOBAL Context Digital Archive Japan/Alamy Stock Photo Contract Law in the European Union If you are doing business with a member state of the European Union, there is one source to turn to in order to understand how the various member states regulate contracts, and that is the Principles of European Contract Law. The principles were drafted by an independent body of experts from each member state of the European Union under a project supported by the European Commission. The principles are stated in the form of articles with a detailed commentary explaining the purpose and operation of each article. Comments to each article provide illustrations, short cases that show how the rules are to operate in practice. Each article also has comparative notes surveying the national laws and other international provisions on the topic. The part of the Uniform Commercial Code that is relevant to contracts is Article 2, which governs contracts for the sale (exchange for a price) of goods (tangible, movable objects). This part of the book will sometimes point out important differences between the UCC and the common law, but the UCC is discussed primarily in Chapters 15 and 16.

Classification of Contracts LO 9-3 Distinguish between bilateral and unilateral contracts. Contracts are classified in a number of ways. Different classifications are useful for different purposes, as the following discussion demonstrates. This section will discuss some of the most useful ways contracts can be classified. Bilateral versus Unilateral Contracts All contracts can be classified as either bilateral or unilateral. Knowing whether a contract is bilateral or unilateral is important because that classification determines when the offeree is legally bound to perform. Whether a contract is bilateral or unilateral depends on what response the offeror (the party proposing the contract) expects from the offeree (the person agreeing to or accepting the contract). If the offeror wants a promise from the offeree to form a binding contract, the contract is a bilateral contract. A bilateral contract is commonly defined as a promise in exchange for a promise. As soon as the promises are exchanged, a contract is formed and the parties's legal obligations arise. For example, when Shannon promises to pay Gary $1,000 in exchange for his promise to paint her car on July 1, they have a bilateral contract. If either party fails to perform, the other may sue for breach. In a unilateral contract, the offeror wants a performance to form the contract. The offeror wants the offeree to do something, not promise to do something. The most common unilateral offer is a reward. If Jim loses his dog, he may post a sign stating "$50 reward for the safe return of my poodle, Frenchie." If Rita calls Jim and says, "Don't worry, I'll find your dog," she is not making a contract because the unilateral offer calls for an action, not a promise. Once she finds Frenchie and takes the dog to Jim, a contract is formed and Jim must pay. Just as the offeree is under no obligation actually to do the act called for by the offeror, the offeror may revoke the offer at any time before performance. However, to prevent injustice, once an offeree begins performance, the offeror must hold the offer open for a reasonable time to allow the offeree to complete the performance. In the Case Opener, the plaintiff would argue that Pepsi appeared to be making an offer for a unilateral contract. In its television commercial, Pepsi promised to provide a prize for a performance, the presentation of a set number of points. By submitting the requisite number of points, the plaintiff believed he was accepting a unilateral offer. BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? Recall that in the Case Opener, PepsiCo required contestants first to mail in Pepsi points before the company would mail the contestant a prize. But what if the Pepsi points contract required only a promise from contestants to send in Pepsi points on a certain date and PepsiCo would send the prize up front? Would the second scenario be a unilateral or a bilateral contract? Page 202 Express versus Implied-in-Fact Contracts LO 9-4 Distinguish express from

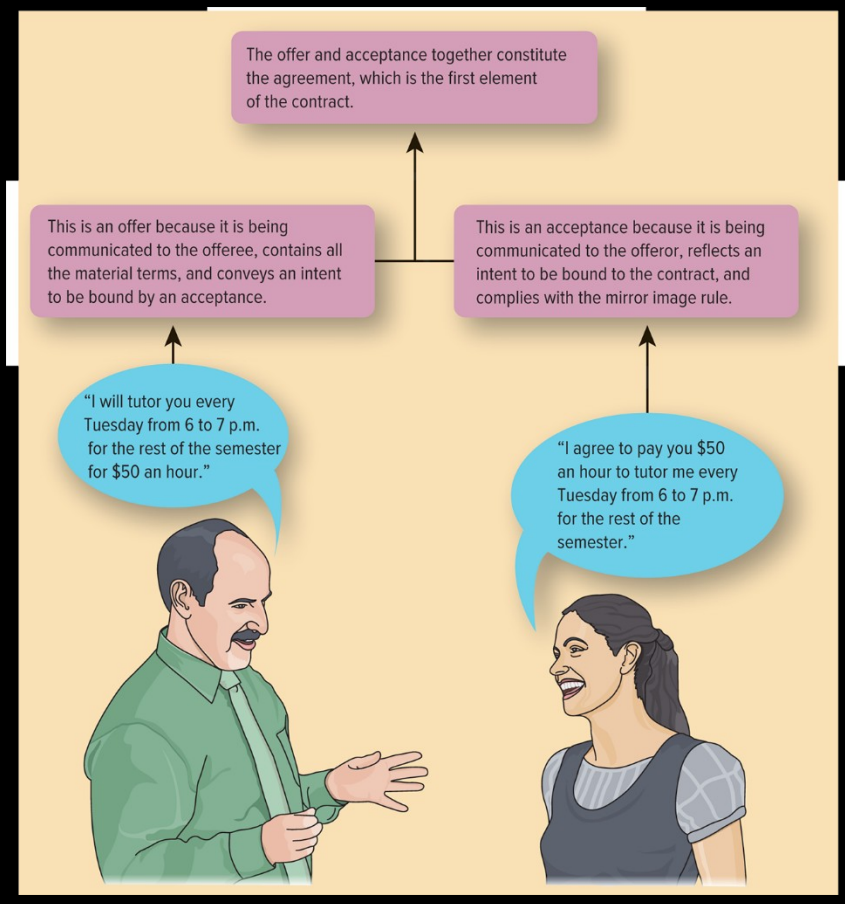
implied-in-fact contracts. Contracts are classified as express or implied, depending on how they are created. The terms in express contracts are clearly set forth in either written or spoken words. The contract in the Case Opener was an express contract; the terms were set forth in the ad and the catalog. Implied contracts, in contrast, arise not from words but from the conduct of the parties. For instance, when you have a dental emergency and your dentist pulls your severely infected tooth without prior negotiation about payment, or even any mention of payment, you have an implied contract for payment for his services. As a general rule, three conditions must be met for the courts to find an implied, or as it is sometimes called, an implied-in-fact contract. First, the plaintiff provided some property or service to the defendant. Second, the plaintiff expected to be paid for such property or service and a reasonable person in the position of the defendant would have expected to pay for such property or services. Third, the defendant had an opportunity to reject the property or services but did not. In Case 9-1, the Court had to decide whether the facts gave rise to an implied-in-fact contract. CASE 9-1 TRAPANI CONST. v. ELLIOTT GROUP INC. Appellate Court of Illinois, First Division 64 N.E, 3d 132 (1016) FACTS: In February 2007, The Elliot Group, Inc., an Illinois real estate developer, made a deal with the Village of Arlington Heights to develop property in that village. Arlington Market, LLC, was subsequently formed by The Elliot Group to develop, manage, and sell the property, a common practice in the residential development industry. Since Arlington Market had no employees, members of the Elliot Group instead managed the LLC. In March 2007, the Trapani Construction Company sent a proposal to The Elliot Group to provide construction services for the Arlington property. Trapani had previously performed work for The Elliot Group. Between March and July of 2007, Trapani sent a total of five draft contracts to the Elliot Group in which the Elliot Group was listed as the contracting party. Although none of the draft contracts were ever signed, Trapani began construction at the Arlington site in early July. The case in question arose after Trapani finished its work at the Arlington site in accordance with the terms of the draft contract and sought payment. Despite having paid Trapani for previous payment requests on the Arlington project, The Elliot Group did not pay the final invoice. Trapani sued for breach of implied-in-fact contract, and The Elliot Group asserted that there was no contract between them and the plaintiff. The trial court ruled in favor of Trapani and The Elliot Group appealed. QUESTION: Was there an enforceable implied-in-fact contract between Trapai and the Elliott Group? REASONING: The Elliot Group argued that, first and foremost, there was no contract between it and Trapani because Elliot never actually accepted

Trapani’s offer. The court pointed out, however, that an implied contract based on the parties’ actions can exist even without clear acceptance. Implied contracts are true, binding contracts that contain the typical elements of offer, acceptance, and consideration. Upon examination of the facts, the court found that all these elements existed. First, an offer existed on the part of Trapani. Trapani often used unsigned draft contracts when working with The Elliot Group. In this case, Trapani negotiated several drafts and proposals with The Elliot Group before and during the project. Second, consideration was provided by both parties. Not only did Trapani provide The Elliot Group with several different construction services during this project, but The Elliot Group even paid for most of the project before suddenly stopping and claiming that no contract existed. Third, acceptance was apparent regardless of The Elliot Group’s claims. Trapani accepted The Elliot Group’s terms when they began work on the project. The Elliot Group, despite its arguments, accepted the contract when it refused to reject Trapani’s work while being fully aware it was taking place (and even paying for the majority of it). Being that the three elements of a contract existed, and especially because of The Elliot Group’s unwillingness to cease Trapani’s work, the court ruled that an implied contract existed between the parties and that The Elliot Group is liable for the costs of the project. DECISION: The Court of Appeals agreed with the lower court that there was in fact an implied contract between the parties, and affirmed the decision in favor of plaintiff Tripani. SIGNIFICANCE: This case clearly outlines the requirements for an implied-in-fact contract and shows that contracts can still exist in the absence of a signed, written contract. CRITICAL THINKING Although in this case, it may seem obvious that facts and circumstances point to the mutual intent to contract, what kind of situations would this be less clear? What kind of evidence would be sufficient, and what kind of evidence would merely be necessary to show the mutual intent to contract needed to show an implied-in-fact contract? ETHICAL DECISION MAKING Which stakeholders’ interests are helped by this decision? Which stakeholders’ interests are harmed? Page 203 Valid, Void, Voidable, and Unenforceable Contracts LO 9-5 Distinguish void, voidable, and valid contracts. What everyone hopes to enter into, of course, is a valid contract. A valid contract is one that contains all the legal elements of a contract as set forth in Exhibit 9-1. As a general rule, a valid contract is one that will be enforced. However, sometimes a contract may be valid yet unenforceable. A valid contract may be unenforceable when some law prohibits the courts from enforcing it. For example, the statute of frauds, discussed in Chapter 13, requires certain contracts to be evidenced by a writing before they can be enforced. Similarly, the statute of limitations

mandates that an action for breach of contract must be brought within a set period of time, thereby limiting the enforceability of the contract. A void contract is, in effect, not a contract at all. Either its object is illegal or it has some defect that is so serious that it is not a contract. If you entered into a contract with an assassin to kill your business law professor, that would be a void contract because it is obviously illegal to carry out the terms of the agreement. A contract is voidable if one or both of the parties can either withdraw from the contract or enforce it. If the parties discover that the contract is voidable after one or both have partially performed, and one party chooses to terminate the contract, both parties must return anything they had already exchanged under the agreement so that they will be returned to the condition they were in at the time they entered into the agreement. Certain types of errors in the formation of a contract lead to it being voidable. Typically, the person who can void the contract is the person whom the court is attempting to protect or the party the court believes might be taken advantage of by the other party. For example, contracts by minors are usually voidable by the minor, as discussed in Chapter 11. Contracts entered into as a result of fraud, duress, or undue influence—a problem with the validity of the acceptance, as described in Chapter 12—may be voided by the innocent party. Executed Versus Executory Contracts LO 9-6 Distinguish executed from executory contracts. Once all the terms of the contract have been fully performed, the contract is said to have been executed. As long as some of the duties under the contract have not yet been performed, the contract is considered executory. For example, if Randolph hires Carmine to paint his garage on Saturday for $800, with $200 paid as a down payment and the balance due on completion of the job, the contract becomes executory as soon as the agreement is reached. When the down payment has been made and the painting is halfway completed, the contract is still executory. Once the painting has been finished and the final payment made, the contract is an executed contract.

The Agreement LO 9-7 Identify elements of a valid offer and a valid acceptance. The first element of a contract is the agreement. As noted earlier, this chapter focuses on contracts governed by common law, that is, contracts other than those for the sale of goods. Under the common law, the agreement begins when one party, the offeror, makes an offer to another party, the offeree. Exhibit 9-2The Formation of a Contract This exhibit illustrates the first element of the contract, the agreement. For a contract to exist, the parties also must have legal capacity to enter into a contract,

exchange valid consideration, and be entering into a contract with a legal purpose. The contract is formed as soon as the second party makes his or her promise. GLOBAL Context Saudi Arabian Flag Offers and Acceptances in Saudi America In most common law countries, including the U.S., advertisements, displays of goods, and so on are considered invitations to buyers to make an offer. Under Saudi Arabia's version of Sharia law, however, advertising a good or a price is considered a binding offer (Ijab) by the seller that is accepted by a buyer. Thus, sellers are required to state their offers in the past tense (i.e., "I am selling this car for $5,000" becomes "I sold this car for $5,000") to demonstrate that, in the mind of the seller, the price is already set and the product is as good as sold. Once a buyer accepts the offer, the seller has no right to revoke the offer. Saudi law also requires agreement and acceptance to all parts of a contract to be completed all at once. If any part of a contract is not accepted during the first negotiation, the entire contract is invalid. This stipulation comes from rule of Sharia law that forbids gharar, or uncertainty, in contracts.


The offer and acceptance together constitute the agreement, which is the first element of the contract.
This is an offer because it is being communicated to the offeree, contains all the material terms, and conveys an intent to be bound by an acceptance.
This is an acceptance because it is being communicated to the offeror, reflects an intent to be bound to the contract, and complies with the mirror image rule.
"I will tutor you every Tuesday from 6 to 7 p.m. for the rest of the semester for $50 an hour."
"I agree to pay you $50 an hour to tutor me every Tuesday from 6 to 7 p.m. for the rest of the semester."

Elements of the Offer An offer has three elements. Under the common law, these elements are intent, definite and certain terms, and communication to the offeree. Intent Page 205 The first element of the offer is intent. The offeror must manifest an intent to be bound by the offeree's acceptance. Contracts are interpreted using an objective standard, meaning that the courts are concerned with only the party's outward manifestations of his or her intent, not what is going on in that party's mind. The courts interpret the words and actions of the parties the way a reasonable person would interpret them. Thus, if an individual is clearly joking or speaking out in anger, the reasonable person would not think that the individual seriously intended to make an offer, and the courts would consequently not treat the words as an offer. If someone attempts to accept such an offer, the courts will not find that a contract has been made. Sometimes an offeror may try to avoid a contract by later claiming that he was only joking when he made the offer, but the courts are not interested in one's hidden intent. As Case 9-2 demonstrates, if you joke too well, you may find yourself in an unwanted contract. CASE 9-2 LUCY v. ZEHMER Supreme Court of Virginia 196 Va. 493, 84 S.E.2d 516 (1954) FACTS: Plaintiffs W. O. and J. C. Lucy had wanted to purchase Ferguson Farm from the Zehmers for at least eight years. One night, Lucy stopped by the establishment the Zehmers operated and said that he bet Zehmer wouldn't accept $50,000 for the place. Zehmer replied that he would, but he bet that Lucy would not pay $50,000 for it. Over the course of the evening, the parties drank whiskey and engaged in casual conversation, with the talk repeatedly returning to the sale of Ferguson Farm. Eventually Lucy got Zehmer to draw up a contract for the sale of the farm for $50,000. When Lucy later attempted to enforce the agreement, Zehmer refused to complete the sale, arguing that he had been drunk and that the agreement to sell the property had been made in jest. Lucy sued to enforce the agreement. ISSUE: Had Lucy and Zehmer entered into a legally binding agreement? REASONING: The mental assent of the parties is not a requirement for the formation of a contract. If the words or other acts of one of the parties have but one reasonable meaning, that party's undisclosed intention is immaterial unless the other party somehow knows that the party does not mean what his words and actions would clearly indicate to any reasonable observer. In this case, not only did Lucy believe that Zehmer was serious when he drew up the contract, but there was no evidence to indicate that any action taken by Zehmer would have indicated that he was not serious. When Zehmer asked his wife to sign the writing that he drew up containing the terms of the sale, he whispered to her that he was joking, but whispered so quietly that Lucy could not and did not hear it. What happened

appeared to be a good-faith offer and a good-faith acceptance, followed by the execution and apparent delivery of a written contract. Therefore, the parties would be held to their outward manifestations of entering into a binding agreement. DECISION AND REMEDY: The parties had entered into a binding agreement, and the court enforced the agreement. SIGNIFICANCE OF THE CASE: This case demonstrates that the courts look at the circumstances surrounding the alleged making of a contract and focus on the outward manifestations of a person's intent. It clearly sends the message that people need to be careful when joking about entering into a contract because a person who jokes too well might find herself or himself bound to an agreement that she or he did not really want to make. CRITICAL THINKING Why must a joke be visibly a joke to a reasonable observer for there to be no acceptance? ETHICAL DECISION MAKING What stakeholders are being protected by the reasoning that supports the rule the court applied in this case? Page 206 BUT WHAT IF. . . WHAT IF THE FACTS OF THE CASE OPENER WERE DIFFERENT? Recall that in the case opener, the Pepsi commercial shows a fighter jet jokingly dropping a boy off at school. But what if the Pepsi commercial featured a man fully capable of owning and operating a fighter jet who turned in an appropriate and realistic number of number of Pepsi points, and Pepsi Company officials subsequently handed him the keys and deeds to such a prize? What if the commercial announcer also turned to the audience and seriously announced that such a prize was included in their prize catalog and could be theirs? Do both scenarios constitute a realistic offer, neither scenario, or only the second scenario? Preliminary Negotiations An invitation to negotiate or an expression of possible interest in an exchange is not an offer. For example, if Rachael asked Bill whether he would sell his car for $5,000, she is not making an offer; she is just inquiring about his potential willingness to sell. Likewise, when a firm or government entity requests bids for a construction project, the request is just an invitation for contractors to make offers. Thus the bids would be the offers. Advertisements Another illustration of the invitation to make an offer is the advertisement. If a custom furniture maker places an advertisement in the paper that reads, "Old-fashioned, hand-crafted cedar rocking chairs only $250 the first week in May," the store is merely inviting potential customers to come to the store and offer $250 for a rocker. Because no reasonable person would expect the store to be able to sell a rocking chair to every person who might see the ad, the court would interpret the intent of the store as being to invite readers to make an offer. Under limited circumstances, however, an ad can be treated as an offer. If it appears from the wording of the ad that the store did in fact intend to make an offer, the

courts will treat it as an offer. In general, when the ad specifies a limited quantity and provides a specific means by which the offer can be accepted, the courts will treat the ad as an offer, as demonstrated by the Case Nugget that follows. The plaintiff in the Case Opener tried to rely on the Lefkowitz case to argue that the Pepsi commercial was an offer because it was “clear, definite, explicit and left nothing to negotiation.” After all, the commercial clearly stated that 7 million points earned a Harrier jet, and the catalog provided an additional means of buying the points for cash. The court in that case, however, found that the commercial could not be regarded as sufficiently definite because it specifically reserved the details of the offer to a separate writing, the catalog. Also, the commercial itself made no mention of the steps a potential offeree would be required to take to accept the alleged offer of a Harrier jet. Page 207 The court further found that the only offer in this scenario was the plaintiff’s letter of March 27, 1996, along with the order form and the appropriate number of Pepsi points. Because Pepsi rejected this offer with its letter, there was no contract. To prevent possible bait-and-switch advertising, some states have consumer protection laws requiring advertisers to state in their ads either that quantities of the item are limited to the first X number of people or that rain checks will be available if the item sells out. CASE Nugget When Is an Ad an Offer? Lefkowitz v. Great Minneapolis Surplus Store, Inc. Supreme Court of Minnesota 251 Minn. 188, 86 N.W.2d 689 (1957) In this case, the defendant had published a newspaper announcement stating: “Saturday 9 AM Sharp, 3 Brand New Fur Coats, Worth up to $1,000.00, First Come First Served $1 Each.” Morris Lefkowitz arrived at the store, dollar in hand, but was informed that under the defendant’s house rules the offer was open to ladies but not gentlemen. The court ruled that because the plaintiff had fulfilled all the terms of the advertisement and the advertisement was specific and left nothing open for negotiation, a contract had been formed. From this case came the often-quoted exception to the rule that advertisements do not create any power of acceptance in potential offerees: an advertisement that is “clear, definite, and explicit, and leaves nothing open for negotiation.” In that circumstance, “it constitutes an offer, acceptance of which will complete the contract.” Auctions Another situation in which what seems to be an offer may not be is the auction. When a person places a good with an auctioneer for sale by auction, is the seller making an offer or is the bidder? The answer depends on what kind of auction is taking place. If nothing is stated to the contrary in the terms of the auction, an auction is presumed to be with reserve. In an auction with reserve, the seller is merely expressing an intent to receive offers. The auctioneer may withdraw the item from auction at any

time before the auctioneer’s hammer falls, signaling the acceptance of the bid. Similarly, at any time before the hammer falls, the bidder may also revoke the bid. In an auction without reserve, the seller is treated as making an offer to accept the highest bid. Thus, the seller must accept the highest bid. Not surprisingly, very few auctions are without reserve. Definite and Certain Terms Under the common law, the terms of the offer must be definite and certain. In other words, all the material terms must be included. The material terms are those terms that allow a court to determine what the damages are in the event that one of the parties breaches the contract. Sometimes an offer contains not the material term itself but a method for determining the term. For example, Guy’s Sailboats is building Sara a sailboat, and the parties want to make it possible for her to pay one-third of the price of the boat in advance, one-third on delivery, and one-third in 12 monthly payments, with interest, beginning a month after delivery. Rather than stipulating an interest rate to be charged on the monthly payments, the contract might specify an external standard according to which the interest rate would be set through the course of the 12-month payment period. Page 208 The question of whether the terms of an alleged offer were adequate for the formation of a valid contract often arises in cases when one party believes that a contract had been formed and the other believes that there had been no contract because the terms of the alleged offer were not definite enough. It is therefore really important when drafting a contract to ensure that all the terms are included and clearly stated. Communication to the Offeree The offer must be communicated to the offeree or to the offeree’s agent. Only the offeree to whom the offer was directed can accept the offer. If Bill overhears Sam offer to sell his car to Helen for $5,000, he cannot walk over and form a contract by accepting the offer. If he says to Sam, “I’ll give you $5,000 for your car,” he is not accepting the offer but, rather, is making a new offer.

Termination of the Offer LO 9-8 Explain how an offer may terminate. At some point in time, offers terminate; when an offer terminates, it can no longer be accepted to form a binding contract. There are five ways to terminate an offer: revocation by the offeror, rejection by the offeree, death or incapacity of the offeror, destruction or subsequent illegality of the subject matter of the offer, and lapse of time or failure of other conditions stated in the offer. Revocation by the Offeror The offeror is said to be the master of his offer and, as such, can revoke it at any time, even if he says he will hold the offer open for a stated period of time. If Jim sends Carol a letter offering to mow

her yard every week during the summer for the price of $20 a week as long as she responds to his offer within the next month, he can still change his mind and tell her at any time before she responds that he is no longer interested in working for her, thereby revoking his offer. If a person wishes to ensure that an offer will in fact be held open for a set period of time, the person may do so by entering into an option contract with the offeror. An option contract is an agreement whereby the offeree gives the offeror a piece of consideration in exchange for the offeror’s agreement to hold the offer open for the specified period of time. There are a number of situations when you might want to enter into an option contract. For example, if the person who made the offer is ill, and you are afraid he or she might die, you would want to enter into an option contract because you would then still have the time of the option to enter into the contract with the estate of the offeror; otherwise, the offer dies with the offeror. You might also want to enter into an option contract if you really want the object of the offer but need time to make sure you can finance it, and you do not want the offeror to sell the item to another party. For example, if the offeror offers to sell you a valuable antique car, but you are not sure you can afford the financing, you might want to get an option contract to give you time to secure financing. There is no requirement as to the value of the consideration. If the consideration is money, the parties may agree that if the offer is eventually accepted and a contract is formed, the consideration for the option contract will become part of the payment for the contract. This situation frequently arises in contracts involving real estate. Jones may be considering opening a restaurant and would like to have the option of purchasing a lot owned by Smith, so he gives Smith $1,000 for a 30-day option to purchase the lot, with the provision that the $1,000 will be deducted from the purchase price if Jones purchases the property. In the event that Jones does not buy the property, Smith will keep the $1,000. The UCC imposes an additional limitation on the offeror’s ability to revoke the offer. A promise to hold an offer for the sale of a good open for a specified period cannot be revoked if it is made in writing and signed by a merchant. As a general rule, the revocation of an offer is effective when it is received by the offeree. Because of this rule, if it is really important to the offeror to know that his offer has been revoked, he should personally deliver the revocation to the offeree. Page 209 Rejection by the Offeree The second means by which an offer can be terminated is rejection by the offeree. Regardless of how long the offer was stated to be open, once the offeree rejects it, it is terminated. In our earlier example, if Carol calls Jim and says that she is not interested in his working for her this summer or any summer because of the poor quality of

the work he has done for her in the past but then calls him back an hour later to say that she has changed her mind and would like to hire him in accordance with his proposed terms, it is too late. There is no offer for her to accept because her rejection terminated the offer. Death or Incapacity of the Offeror The offer terminates immediately if the offeror dies or loses the legal capacity to enter into the contract. This termination occurs even if the offeree does not know of the terminating event. The exception to this rule occurs when the parties had already entered into an option contract to hold the offer open for a set period of time. If an option contract exists, the administrator of the offeror’s estate or the guardian of the offeror must hold the offer open until it expires in accordance with the option contract. Destruction or Subsequent Illegality of the Subject Matter If the subject matter of the offer is destroyed or becomes illegal, the offer immediately terminates. For example, if Jamie offers Bill a job managing the riverboat casino he plans to open on January 1, but, before Bill accepts the offer, the state decides to no longer allow riverboat casinos to operate in the state, the offer of employment terminates. Lapse of Time or Failure of Another Condition Specified in the Offer As noted earlier, the offeror has the power to revoke the offer at any time, even if the offer states that it will be held open a set amount of time. But if the offer states that it will be held open for only a certain time, the offer will terminate when that time expires. In the absence of a time condition in the offer, the offer will expire after the lapse of a reasonable amount of time. What constitutes a reasonable amount of time varies, depending on the subject matter of the offer. For example, an offer by a retailer to purchase seasonal goods from a wholesaler would lapse before an offer to purchase goods that could be easily sold all year long. CASE Nugget Details in the Offer Matter Lee v. Chemielewski 290 So.3d 5411 (Fla. Dist. Ct. App. 2019) Litigation stemming from a car accident led to a jury awarding the plaintiff over $14 million in damages. The defendant appealed, arguing that he had already accepted the plaintiff's previous settlement offer of $10,000. Though the defendant had raised this issue, the trial court had denied it. The plaintiff naturally contended that though his counsel did send the settlement offer, it had expired by the time defendant had accepted. The offer stated in part, “This offer will remain open for fourteen (14) days from the date of this letter, after which it will be withdrawn without further notice.” Plaintiff's counsel had made the offer on November 26, and the defendant, represented by Geico, responded fourteen days later, on December 10. On that day, Geico had faxed an acceptance letter at 5:42 p.m. and then sent a representative with the $10,000 check who arrived at the plaintiff's counsel's office between 7:00 to 7:15 p.m. that evening. At

issue was whether the fourteenth day expired at 5:00 p.m., the end of the business day, or midnight. The court first determined whether Geico 's actions were within the timing of the offer. It reasoned that the plaintiff's offer did not indicate an expiration time on the fourteenth day and stated, "we cannot read such a limitation into the offer." Accordingly, Geico took action while the offer was available. The next question was whether Geico 's actions constituted acceptance. The court ruled that the settlement offer was a bilateral contract, and GEICO only needed to promise payment to accept the offer, which it did by faxing the letter at 5:42 p.m. on the fourteenth day. Even if the settlement offer was a unilateral contract, the court reasoned that Geico had accepted the offer by trying to deliver the $10,000 check. In the end, the appellate court held that the trial judge erred in determining that the defendant had failed to accept the settlement offer. The $14 million jury verdict was reversed.

Elements of the Acceptance Once an offer has been made, the offeree has the power to accept that offer and form a contract. In examining the acceptance under the common law, the basic requirements for a valid acceptance parallel those for a valid offer. There should be a manifestation of intent to be bound by the acceptance to the contract, agreement to the definite and certain terms of the offer, and communication to the offeror. Manifestation of Intent to be Bound to the Contract In general, there are two ways an offeree can manifest her or his intent to enter into the contract: by performance or by a return promise. The offeree must either do something or say something to form the contract. Recall the distinction between a bilateral contract and a unilateral contract. If the offer is for a unilateral contract, the offeree can accept only by providing the requested performance. If Bill offered to pay $500 to anyone who returned his lost dog to him, Mary could accept the offer only by returning the dog. Bill did not want her promise, and if she called and promised to return the dog to him, that promise would have no legal effect because the only way to accept a unilateral offer is by performance. With a bilateral contract, what the offeror wants to form the contract is not performance but, rather, a return promise. Sometimes, however, it is not clear whether the offeror wants performance or a return promise. In such a case, the offeree has the option of either performing or making a return promise. Silence as a Form of Acceptance Silence, as a general rule, cannot be used to form a contract. For example, Lisa and Marie both work at a local diner where the manager is very flexible and lets the waitresses trade shifts. Marie calls Lisa and leaves her a voice-mail message

saying, “I can’t work my three night shifts this week. If you can cover them for me, I’ll pay you an extra $40 on top of the money you’ll receive from the boss for working my shifts. If I don’t hear from you by 7 p.m. tomorrow, I’ll assume we have a deal and you will work for me. Thanks so much!” If Lisa does not call back, no contract has been formed because silence under these circumstances would not constitute an acceptance. Page 211 The Restatement of Contracts, however, offers three circumstances under which silence can be an acceptance. First, the offeree receives the benefits of the offered services with reasonable opportunity to reject them and knowledge that some form of compensation is expected, yet the offeree remains silent. Second, the offeror tells the offeree that silence or inaction will constitute an acceptance, and the offeree, by remaining silent, intends to accept. Third, the parties, by their previous course of dealing with each other, have established a pattern of behavior whereby it would be reasonable to assume that silence was intended to communicate acceptance. For example, a wholesaler and retailer have a long-standing relationship in which the wholesaler routinely ships a certain type of merchandise to the retailer, who rejects a shipment if it does not meet his needs. After such a pattern of behavior has been established, it is reasonable for the wholesaler to assume that when a shipment is not sent back, the retailer means to accept it. Acceptance of definite and Certain Terms: The Mirror-Image Rule When a bilateral contract is being formed under the common law, the mirror-image rule applies to the acceptance. The mirror-image rule says that the terms of the acceptance must mirror the terms of the offer. If the terms of the acceptance do not mirror the terms of the offer, no contract is formed. Instead, the attempted acceptance is a counteroffer. The following case provides an illustration of how the mirror image rule can be applied. CASE 9-3 REED V. EZELLE INVESTMENT PROPERTIES, INC., United States District Court for the District of Oregon 353 F. Supp. 3d 1025 (D. Or. 2018) FACTS: Aaron Reed, a photographer, was in a dispute with Ezelle Investment Properties, Inc. over Ezelle’s allegedly using one of Reed's photographs without permission. Reed sent Ezelle a cease-and-desist letter along with a proposed settlement agreement that gave Ezelle the option of immediately settling for $5,000. The settlement agreement contained, among other things, a confidentiality clause. After negotiations, the parties agreed to the amount of $1,000. Ezelle sent Reed a check for $1,000, along with a signed settlement agreement with the confidentiality clause crossed out. Reed accepted the payment but told Ezelle that the confidentiality clause was nonnegotiable. Reed then demanded $20,000 to settle the case. Shortly thereafter, Reed filed suit. Ezelle moved for summary judgment, arguing that

the settlement agreement precluded Reed's suit.. ISSUE: Can there be a valid contract if the terms of an acceptance change any of the terms of the offer? REASONING: There is no binding settlement agreement in this case because Ezelle’s purported acceptance modified a material term of the offer and thus constituted a counteroffer. Reed’s first email to Ezelle was a copy of the Proposed Settlement Agreement, which contained the confidentiality clause at issue. The parties negotiated the settlement amount for the next several weeks. Ezelle proposed a settlement amount of $1,000, and Reed sent Ezelle another copy of the Proposed Settlement Agreement containing the confidentiality clause to be signed and returned with payment of $1,000. Ezelle mailed a $1,000 check to Reed with a signed copy of the Proposed Settlement Agreement, but with the confidentiality provision crossed out. Under the mirror image rule, Ezelle’s tender, which included the deletion of the confidentiality clause, constituted a rejection of Reed’s offer and a counteroffer that Reed was then free to accept or reject. Because Reed did not accept this counteroffer, the parties did not enter into a binding settlement agreement as a matter of law. DECISION: Because there was no acceptance of Ezelle’s counteroffer, there was no contract, and plaintiff Reed’s lawsuit was allowed to continue. SIGNIFICANCE OF THE CASE: This case illustrates how important the mirror image rule is because not understanding how this rule applies can lead parties to think they have a contract when they do not have one. CRITICAL THINKING Can you think of any additional information that could have changed the outcome of this case if the defendant could have provided it? ETHICAL DECISION MAKING If each party had been thinking about the universalization test when taking the actions that led to this litigation, do you think either of them would have behaved differently? Why or why not? GLOBAL Context Digital Archive Japan/Alamy Stock Photo Contracts in Japan The Japanese tend to view contracts as ongoing relationships in which the parties work with each other to smooth out any problems that arise in performance of the contract. The Japanese tend to be suspicious of long, detailed contracts. They have a distinct preference for short, flexible contracts that leave a number of terms to be decided later. When negotiating a contract with a Japanese businessperson, an American businessperson must recognize how the Japanese will interpret his attempts to include more details in the agreement. The American should think about which details are essential for inclusion. Page 212 The mirror-image rule has caused a significant amount of trouble for businesses because often a buyer would make an offer on one form that contained not only the essential terms of the contract but also a number of additional, somewhat minor terms. Generally, the offer was on a standard

form that had a place where the essential terms were written in. The seller would often return his standard form with its preprinted terms, along with the essential terms written in to match the terms of the offer. The problem was that because these preprinted forms did not match, there was legally no contract. If both parties performed their contracts, no problems arose; but the fact that there was no contract meant that on occasion one party could decide simply to not perform, leaving the other party with no remedy. Or, if the parties did perform, the buyer might perform according to the terms on the buyer's form and be sued for breach by the seller, who believed that the terms on the seller's form were the terms of the agreement. To eliminate this problem of the battle of the forms, UCC Section 2-207 significantly modified the mirror-image rule by providing that, as a general rule, an offeree may include in the acceptance terms that are additional to or different from the terms of the offer as long as (1) the offeror did not explicitly state in the offer that all terms of the offer must be accepted exactly as proposed; (2) the offeror does not promptly reject the new terms on receipt of the acceptance; and (3) the new terms do not materially change the terms of the original offer. In the case of additional terms—terms related to issues not addressed in the original offer—if none of the foregoing conditions occur, a contract is formed and the terms of the agreement are those of the acceptance, as long as the parties are merchants. If the parties are not merchants, the additional terms are merely proposals for additions to the contract and must be accepted by the offeror. Page 213 If the terms of the acceptance are different from those in the offer, various states treat the terms differently. In most states, the terms are said to cancel each other out, and the courts then look to the UCC for neutral terms to insert into the contract. Communication to the Offeror An offeror has the power to control the means by which the acceptance is communicated, and if the offeror specifies that only a certain means of communication will be accepted, then only that method of communication forms a valid offer. Suppose, for example, that Jennifer offers to paint Bill's car for $500 but says that he must accept the offer by telephone before midnight on Thursday. If he sends her an email Thursday morning accepting her offer, there is no valid contract. Even though email might be a valid means of accepting a contract offer if no means is specified, when the offer is limited to a specific means of communicating the acceptance, only that means results in a valid contract. Thus Bill's attempted acceptance was simply a new offer. If no means of communicating the acceptance is specified, any reasonable means is generally acceptable. Telephone, telegraph, mail, fax, and email are all valid means of accepting an offer. If a person drafting an offer wants acceptance to be only by a particular

means, the offer must make it clear that only a certain means is allowed. The Mailbox Rule Because not all acceptances are made in person, a rule needed to be developed to determine the point at which an acceptance made through the mail became effective. The courts settled on the mailbox rule, which provides that an acceptance is valid when it is placed in the mailbox, whereas a revocation is effective only when received by the offeree. Today, the mailbox rule has been expanded to apply to faxes in some jurisdictions, with courts holding that once the fax has been transmitted, the acceptance is effective. It is likewise applied to email transmissions in that once the acceptance is sent, it is considered accepted. E-Commerce and the Law Disclosure of Definite and Certain Terms Many people would like to know what sort of terms they will be held to when buying a product. Unfortunately, many people who aren't aware of the importance of receiving prior disclosures also don't realize that online businesses commonly refrain from giving full disclosure of terms about a product until the payment information has already been given. If e-businesses do happen to provide these certain terms before a customer agrees to buy a product, the link to the terms themselves may be hard to find. Another aspect of the terms (if given) is that the language in which the contract is written is dense legal language, which may be hard for the ordinary person to understand fully. These e-business practices in regard to disclosure of terms can be very deceptive. A customer may inadvertently agree to a contract when he or she is given only some information about it. This situation would be as if a student were given a page of text that appeared to be whole and complete, and the student had completed an entire report on the text before being given an additional 50 pages that were also part of the text. Those customers who shop online should be aware of the potential for deception with online sellers and should use caution when making purchases. The Effect of an Acceptance after a Rejection As previously stated, if an acceptance is received after a rejection is received, the acceptance is not valid because the rejection terminated the offer. However, sometimes a rejection is dispatched, but before it is received, the acceptance is communicated to the offeror. In that case, a valid contract has been formed because the rejection is not effective until it is received. Suppose Brenda emails an offer to Harry, and he puts a rejection in the mail. Then, before the rejection is received, Harry calls Brenda and tells her he accepts. A valid contract has been formed, and the rejection will have no effect when it is received. However, if the telephone call had been made after Brenda had received the rejection, there would have been no contract. Page 214 E-Commerce and the Law Who Signed the Contract? When the pandemic swept through the world in 2020, countries around the globe

mandated masks, nonessential store closures, and social distancing. Although Electronic Signature use was gaining prevalence before the pandemic, the stay-at-home and social distancing measures caused their use to skyrocket. Valid contracts must have both an offer and an acceptance. The agreement can be made through oral or written communication—including eSignatures. Companies like DocuSign tout the reliability and security of eSignatures over wet-ink signatures. For example, every DocuSign eSignature has an audit trail with a timestamped history of every viewing, printing, sending, signing, or declining activity. Still, eSignature has run into problems. In Fabian v. Renovate America, Inc., Renovate America contracted with Ms. Fabian to install a solar energy system in her home. However, Ms. Fabian maintained that she had never agreed with Renovate. Renovate argued that Ms. Fabian electronically signed the agreement and produced a 15-digit alphanumeric DocuSign eSignature purportedly signed by Ms. Fabian. Despite the DocuSign audit trail, the court held Renovate could not prove it was Ms. Fabian that put the electronic signature on the agreement. In another case, Banc of America Services sued IO Moonwalkers, Inc., because of a dispute over chargebacks. Moonwalkers claimed it had never electronically signed the contract even though Banc of American could supply DocuSign records. Moonwalkers contended that even though DocuSign data showed someone using a Moonwalkers company email viewed and signed the agreement, the signer was not authorized; Moonwalkers should be off the hook. Ultimately, the court held that the audit trail, together with Moonwalker's other actions following the contract terms, showed that Moonwalkers had agreed to the contract. Sources: Electronic Signatures: Not So Fast (americanbar.org); Using E-Signatures in Court — The Value of an… | Fenwick & West LLP; 7 landmark electronic signature legal cases | ESRA (esignrecords.org.) CASE OPENER W R A P-U P The Problematic Promotion Much to the plaintiff’s dismay, the court in the Pepsi case found that the commercial could not be regarded as sufficiently definite to be an offer, because it specifically reserved the details of the offer to a separate writing, the catalog. Also, the commercial itself made no mention of the steps a potential offeree would be required to take to accept the alleged offer of a Harrier jet. As in most cases where a consumer attempts to place an order for an advertised item, the court regarded the plaintiff’s purported acceptance as an offer. And it was an offer that Pepsi obviously rejected. And, while the court did not specifically mention this factor, common sense should have indicated to the plaintiff and his family that Pepsi did not really intend to give a Harrier jet as one of the promotional prizes. PRACTICAL TIPS for Business Managers When negotiating a contract with another business,

be sure to take your time to discuss the nature and expectations of the proposed relationship and to prepare for any problematic contingencies. You could be saving yourself a lot of time and money by making sure that the contract is complete and clear now instead of fighting about the contract in court later. Remember that contracts do not necessarily have to be in writing to be binding agreements. Whenever discussing an agreement with another party, keep in mind the criteria of an implied contract so you know whether you are agreeing to something that is binding. Lucy v. Zehmer is a classic example of how an offer in jest can still be a reasonable and binding offer. While the authors are not suggesting that you never crack another joke, it is always wise to be careful and deliberate with your words, especially when those words may sound like an offer to a reasonable listener.

SUMMARY The Definition of a Contract Contracts at their simplest level are legally enforceable agreements. A valid contract is generally viewed as one that has the following elements: agreement, consideration, legal object, and parties with legal capacity. Sources of Contract Law There are two sources of contract law: the Uniform Commercial Code and state common law. The Uniform Commercial Code, in Article 2, governs contracts for the sale of goods. All other contracts are governed by the common law. Classification of Contracts Contracts may be classified in a number of ways. Every contract is either unilateral or bilateral; express or implied; valid, voidable, or void; executed or executory; and formal or informal. The Agreement The agreement is the first element of a contract. It begins when one party, the offeror, makes an offer to another party, the offeree. Elements of the Offer A valid offer contains the manifestation of the offeror’s intent to be bound to the definite and certain terms that are communicated to the offeree. Termination of the Offer An offer can be terminated by revocation by the offeror, rejection by the offeree, death or incapacity of the offeror, destruction or subsequent illegality of the subject matter of the offer, or lapse of time or failure of other conditions stated in the offer. Elements of the Acceptance An acceptance is valid when a manifestation of intent to be bound to the terms of the offer is communicated to the offeror by the offeree.

Point/Counterpoint Innovations in blockchain technology, the system by which cryptocurrencies such as Bitcoin operate, have made possible a new type of contract: the smart contract. Smart contracts are contracts written in

computer code that automatically executes when a set of conditions is met. For example, say one party wants to rent an apartment from another. They can set up a smart contract that is coded so that when the landlord sends the renter the digital entry key to the apartment, sufficient funds will automatically be transferred from the renter's bank account to the landlord. If the key does not arrive, no funds are sent. The contract is encrypted and stored digitally on computers, and the contract's code cannot be altered by either party without alerting the other. Should the Business World Embrace Smart Contracts? YES NO Smart contracts utilizing blockchain technology have many benefits over traditional contracts and will no doubt be the new standard in only a few years. Perhaps the biggest benefit of smart contracts is that they entirely cut out the middleman. No longer does someone need to draft a physical contract, track down a lawyer or notary, pay to have the contract notarized, and wait for all the paperwork to go through. With a smart contract, the parties simply need to decide on their terms and create a smart contract. The smart contract can contain all the rules, penalties, and terms of a conventional contract, but a smart contract will automatically enforce the obligations. Businesses can save time and money by switching over to smart contracts. Another benefit of smart contracts is that they are secure, both from interference from the contractual parties and from malignant third parties. This means that there's no possibility for either party to change the contract in bad faith without alerting the other party, effectively nullifying the changes. Arguably, due to the smart contract's data being kept on a decentralized cloud ledger, smart contracts are more secure from hackers than traditional online transactions where the data is stored on one set of servers owned by a business. A final advantage of smart contracts is that they require accountability of both parties. The smart contract blockchain acts as a ledger that keeps track of all the actions taken by the parties concerning the contract. For example, say a business wants to hire a trucker to ship their products to a buyer. The trucker delivers the product, the delivery is recorded in the blockchain, and the smart contract then transfers the trucker's fee to his account. Later, the trucker tries to scam the business into paying him twice by claiming that he has not been paid. However, one needs only to look at the blockchain ledger to see that the payment did indeed go through. No trickery or confusion can occur in a smart contract, meaning the chances of breach are far lower and everyone is more likely to get what they want. While great strides in blockchain technology have been made in the last few years, smart contracts simply are not ready to be adopted by the business world quite yet. First of all, while it is true that traditional contracts can contain many complicated clauses and

terms, at least they are written in English. Smart contracts are written in code, meaning a business needs to hire a coder or programmer to write smart contracts. But coders are people too, and they can make mistakes. Whereas a traditional contract can be reviewed by the parties for errors, it is much harder for individuals untrained in a programming language to proofread a contract. This can even be used to gain an unfair advantage if one party can read the code and the other cannot. Another problem with smart contracts is that once they are written and implemented into the blockchain, they are immortal and unchangeable. A smart contract cannot be edited or revoked without writing an entirely new smart contract to override the previous one (and even then, the original smart contract still technically exists). This fact exacerbates any errors made in the “drafting” process of a smart contract, as any submitted errors are unfixable. This fact leads to several issues. First, if a government entity one day decides to regulate smart contracts, existing contracts may have provisions that are made illegal by new legislation (or, perhaps, the entire concept of a smart contract may be made illegal). Second, there is no set of governmental laws in place to make smart contracts legally binding. While the advocates of smart contracts tout that smart contracts are automatically enforceable and therefore either the deal goes through 100 percent or not at all, it seems shortsighted to think that smart contracts will inevitably work out in every circumstance and/or that no one will be wronged by a smart contract. Thus, it is probably unwise for a business to begin using smart contracts without a protective legal framework.

Questions & Problems Explain why the first question a person should ask when getting ready to analyze a contract problem is, “Is this alleged contract a contract for the sale of a good?” What is the difference between an offer for a unilateral contract and an offer for a bilateral contract? Why might that difference be important to understand? What is the difference between an express and an implied-in-fact contract? What is the mirror-image rule? What is the mailbox rule? In 2014, Julie Gerstenecker, who was married to Adam Gerstenecker, had approximately $78,000 of student loan debt. Hearing Julie lament about the interest on her loans, Adam’s mother, Janice Gerstenecker offered Julie an interest-free loan to pay off her student loan debt in return for monthly payments. In September 2014, Julie sent Janice an email with the details of Julie’s student loan debt. The next day, Janice mailed checks covering the full amount of Julie’s debt to the Department of Education Federal Loan Servicing and Sallie Mae. The agreement was not put into

writing. In early 2015, Julie and Adam were going through divorce proceedings. An email exchange between Julie and Adam discussing divorce terms indicated that Julie's monthly payments to Janice would be reduced from $700 per month to $500 per month. In December 2015, after a year of nonpayments, Janice sued Julie for breach of contract. In the trial, Janice testified that she had received four checks from Julie before the payments had ceased. Julie testified that she had no recollection or explanation as to why she had sent those checks to Janice. Ultimately, Julie argued that there was no contract between them because "[t]here is no tangible evidence supporting the assertion that Julie intended to agree to pay [Janice] back." What are the two ways an offeree can manifest intent to enter into the contract? Although there was no explicitly signed contract, what actions by Julie indicate that there was an agreement of the offer? How do you think the court ultimately resolved this case? Source: Gerstenecker v. Gerestenecker, Ala: Supreme Court (2017). Page 217 Timothy Reddick served in a two-year term appointment with the FDIC, with the term lasting from September 2010 to September 2012. In April 2012, prior to the end of the contract, the FDIC offered an extension to Reddick subject to the condition of Reddick's continued successful performance. Reddick accepted the offer several days after it was made. Unfortunately for Reddick, the FDIC revoked the extension offer in August 2012 due to his failing to meet the condition of continued successful performance by engaging in "highly questionable behavior." His employment with the agency terminated in September 2012. Reddick subsequently sued the FDIC. Do you think the FDIC was allowed to revoke the offer after Reddick's acceptance? Explain your reasoning. Source: Reddick v. FDIC, 809 F. 3d 1253 (2016). In August 2014, Superior Structures of Ohio, LLC, and its president, Ryan Villhauer, applied for credit with Willoughby Supply Company, Inc. The application contained a section providing for a personal guarantee, including language that named Villhauer as the guarantor and the statement "This application will not be approved if personal guarantee is not signed." Directly beneath this section, Villhauer handwrote his name on the "name" line but left the signature line blank. Willoughby Supply granted credit to Villhauer and Superior Structures, and Superior Structures made multiple purchases from Willoughby Supply on this credit. Villhauer and Superior Structures defaulted on the credit and refused to pay Willoughby Supply, resulting in an unpaid balance of $28,832. Willoughby Supply sued Villhauer to collect the debt. Villhauer moved to dismiss the case, arguing that he could not be held liable because he did not sign the personal guarantee. The trial court granted Villhauer's motion. Did a contract exist between Willoughby Supply and Villhauer? How do you think

the appellate court ruled? Source: Willoughby Supply Co. v. Villhauer, 2018-Ohio-2077. In April 2011, Elias Groisman entered into a contract with Shabsi Pfeifer to sell three real properties to Pfeifer on the condition that Pfeifer satisfied two liens on the properties against Groisman's name and upon payment of $55,000. The email which contained the offer did not have an end date by which Pfeifer had to complete performance. More than six months later, Groisman entered a contract of sale for the three properties with Maya Development, LLC. In December 2012, Pfeifer filed a complaint against Groisman and Maya Development, seeking specific performance of the contract for the sale of real properties. The trial court dismissed the case, and Pfeifer appealed to the New York Appellate Division Supreme Court. Did Groisman and Pfeifer enter into a valid contract on April 2011? What kind of agreement did both parties have instead? Based on your answers to the previous answers, who won the court case? Why? Source: Shabsi Pfeifer v. Elias A. Groisman, et al., 997 N.Y.S.2d 706 (N.Y. App. Div. 2014). Panther Racing, LLC, is involved in competitive racing, including the development, maintenance, and operation of a racing team in the IndyCar series. Beginning in 2008, the National Guard annually sponsored Panther racing teams in the IndyCar series to advertise itself. According to Panther's CEO, John Barnes, Panther's practice was to prepare for the next racing season before there was a written sponsorship agreement in place. In 2012, the Guard entered a sponsorship contract with Panther. In 2013, Barnes met with LTG Ingram, Director of the Army National Guard; Ingram told Barnes that the Guard's sponsorship of Panther was authorized and fully funded for the 2014 season, thus Panther should not seek other sponsors. During a later phone conversation, Panther was advised that another member of the Guard, Sgt. Kosa, had "full authority to represent the Guard in its communications with Panther regarding the sponsorship. However, an internal Guard memo expressly stated that Sgt. Kosa "was not authorized to award, agree to, or sign any contract modification, or in any way obligate the payment of money by the Government." Sgt. Kosa went on to tell Panther that the Guard authorized renewal sponsorship contract for 2014 and that Panther should prepare for the 2014 season. However, Panther's contract was not extended. By the time it found out, it had already incurred costs while preparing for the 2014 season and did not have time to find another sponsor. Panther sued the Guard for reimbursement of its costs, arguing that Sgt. Kosa had implied authority to bind the government and that there was an implied-in-fact contract in place. Is the contract in effect even though the Guard did not authorize Sgt. Kosa to renew it? How did the court rule? Source: Panther Brands, LLC v. United States, No. 16-1157C (Fed. Cl. 2019). Page 218 Counsel

for plaintiff Enedina Trujillo de Paz made a pre-suit offer to State Farm Mutual Automobile Insurance Company (defendant Ana Alberto de Pineda's insurer) to settle damages arising from an auto accident. The offer required that a payment of $25,000 (the policy limits) be “received in [the plaintiff's counsel's] office within 10 days after your written acceptance of this offer to settle,” and stated that “Timely payment is an essential element and condition of acceptance by either party.” On behalf of the defendant, State Farm made a written acceptance of the offer on July 6, 2018, and arranged for a $25,000 draft to be picked up by United Parcel Service (UPS) and sent to the plaintiff's counsel via overnight delivery. UPS apparently lost that draft, and the plaintiff's counsel did not receive a replacement draft in his office until July 30, 2018, more than 10 days after State Farm's written acceptance. After the plaintiff took the position that the parties had not reached a settlement agreement, the defendant filed a motion to enforce a settlement agreement, arguing that she accepted the settlement offer when she gave the payment to UPS for delivery. The trial court agreed and held that the parties had created an enforceable settlement agreement, concluding that the defendant's counsel “did not commit an error and did everything possible to comply with the terms of the agreement” when he sent the payment by overnight delivery via UPS. Plaintiff appealed on grounds that the terms of her unilateral offer had specified that the payment be received in plaintiff’s counsel’s office within 10 days of the written acceptance of the offer to settle, and since the check had not been received within 10 days, no contract had been formed. How do you think the court of appeals resolved this matter? Why? Source: de Paz v. de Pineda, 361 Ga. App. 293 (2021).